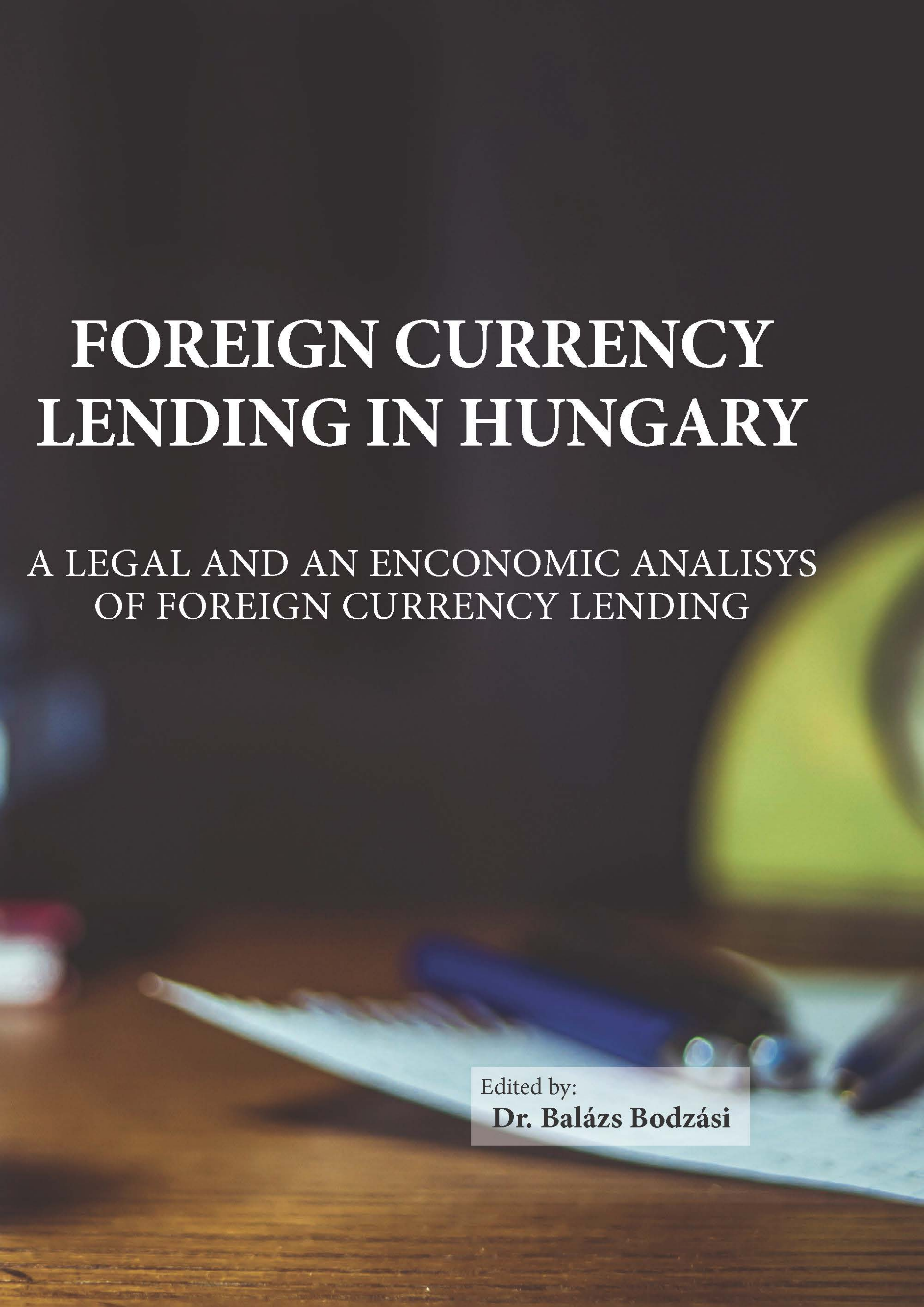

FOREIGN CURRENCY LENDING IN HUNGARY

A LEGAL AND AN ENCONOMIC ANALISYS OF FOREIGN CURRENCY LENDING

Edited by:
Dr. Balázs Bodzási

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Corvinus University of Budapest
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PREFACE

During the 19th and 20th century, the Hungarian society experienced many upheavals. There is one substantial common element in these historically traumatic changes: all of them were affecting the approach of Hungarian society towards property.

As a result of the Revolution and Freedom Fight of 1848-1849 feudal ownership was abolished and civil private ownership was born. The fact that development of civil society and modern private ownership could only take place under the Austrian rule was one tragic event of Hungarian history in the 19th century. This also gives an explanation to the impact of Austrian private law that lasts to this day.

Although after World War I, this development was already within the framework of an independent Hungarian state, however the Hungarian state that became independent again was a country with a significantly mutilated area and economically converging to bankruptcy in 1920. Another historical tragedy was the development of the communist dictatorship and the almost total abolishment of private property after World War II.

The own property of the Hungarian population was practically limited to properties that provides for housing. It is no coincidence therefore, that Hungarian society has developed a very close link towards residential real estate and the agricultural land following the traditions of the former archaic peasant society. The consequence of the above is the high percentage of homeowners in Hungary, which is also outstanding in European comparison.

Hungarian people have always preferred wholly owned apartments against renting a home. This only has been intensified after the change of regime, when private property was once again recognized.

As the demand of the people for owning real estate property has remained unchanged for decades, the political leadership had to take it into account both after 1945 and after the change of regime. Means by which the housing stock could be increased and the desire of the Hungarian people to own apartments could be met were necessary to be found.

This has become a traditional tool for state-supported housing loans. It has already appeared in socialism, and, became a popular tool again after the economic recession of the 1990s at the turn of the millennium, by which the number of new housing constructions has risen over 40,000 again. This demand and tendency had to be taken into account by the governments after the political change in 2002. However, a decision of switching from domestic retail lending to foreign currency lending was made, instead of state support, for various reasons. This volume intends to present, inter alia, the consequences of this step.

In Hungary, retail currency lending has become one of the major economic, legal and partly social problems of the 2000s. Many studies, articles and volumes have already dealt with the causes and consequences of its development and spread. I would like to refer to only one of those works: a multi-authored volume of studies edited by Professor Csaba Lentner in 2015 (The Great Handbook of Foreign Currency Lending, National Public and School Publisher, Budapest, 2015).

A similar, multi-authored work is now in the hands of the Reader. In the background of the idea of publishing such a volume was the fact that by 2018 the crisis caused by foreign currency lending was largely over, most of the issues raised were resolved. Naturally, there are still pending trials before domestic and European judicial forums and, unfortunately, there are still enforcement procedures related to foreign currency loans.

Part of the society was seriously affected by the drastic weakening of the forint exchange rate, after 2008 and for some the significant rise in real estate prices in recent years has not solved their problems with foreign currency loans.

However, the situation of many debtors has been resolved and nothing could demonstrate better that this crisis is behind the country, from the point of view of the national economy, than the fact that retail mortgage lending has begun to show huge growth rates again for years. This means forint loans, of course. At the same time, however this also carries potential risks, therefore it is worth summing up the lessons learned from foreign currency lending.

The volume comprises the work of eighteen authors. As an editor, I found it important to compile an authorship that involves both economists and lawyers. I was looking for "witnesses' who came into direct contact with this "banking product" from banking or a regulatory or a legislative point of view. On the one hand, these are professionals who have seen how retail currency lending was spreading and becoming a threat to the entire Hungarian economy, directly from the beginning of the 2000s, and on the other hand, professionals who had an active role in the legislation when dealing with this issue, after 2010 and 2014.

I would like to use this opportunity to express my gratitude for your work.

The volume is quite colorful: many authors, multiple points of view. As an editor, I obviously do not agree with all the positions, but I considered it important to try to capture these differing opinions. Let us show what these professionals thought about the events of 8-10 years ago, in 2018.

Whoever was right will be determined by the Reader or the events of the coming years. Capturing a decisive segment of the last 15 years period of the Hungarian history in a scholarly and objective manner as far as possible, is what was important to me. Hopefully this goal has been achieved.

Budapest, 7 May 2019

Dr. Balázs Bodzási
editor

László Balogh
Deputy State Secretary,
Ministry of Finance

THE FIFTEEN YEARS OF FOREIGN EXCHANGE LOANS IN HUNGARY (LAUNCH, MANAGEMENT AND INTERNATIONAL BACKGROUND)

1. International outlook, genesis

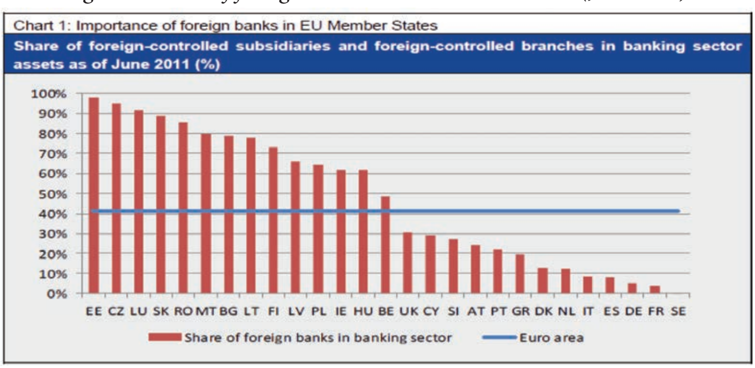
Foreign currency lending is not an unknown phenomenon either in Europe or outside Europe. Some examples of foreign currency lending were already known before the European currency loan crisis, both in the developed world (Australia) and in developing countries (Mexico). The reason why foreign currency lending is attractive is quite simple: the interest rate difference between the national currency and the foreign currency is so large that a loan denominated in a foreign currency seems to be more favourable to the borrower (and the key word here is *seems*) than the same loan in the national currency. This phenomenon is usually coupled with higher inflation in the home country, while the inflation rate in the country of the foreign currency is relatively low. The trap is the prevailing exchange rate risk associated with the foreign currency, particularly for longer-term loans.

In Europe, the FX loans first emerged in Austria in the mid-1990s, mainly in areas of the country near the Swiss border. Austrian commercial banks found that local residents (and entrepreneurs) were happy to drive 15–20 km to a bank on the Swiss side of the border to take out a loan in Swiss francs (CHF), rather than in Austria in the local currency, due to the 1.5 per cent to 2 per cent interest rate difference. In response to this competitive challenge, some Austrian credit institutions included Swiss franc loans in their credit product portfolio. The product soon became available all over Austria and quickly became popular; in 2005 around 30 per cent of the total residential loan portfolio already consisted of this type of loan. This was the beginnings of one of the most dangerous "financial time bombs" of the 21st century, which later caused major problems in the Central Eastern European region, even becoming a systemic risk factor in some countries, primarily in Hungary.

How can it be explained how foreign currency lending in the 21st century, started in Central and Eastern Europe, expanded at such an extremely fast pace? This was basically caused by three factors:

a. The establishment of foreign, typically Austrian and Italian banks in the Central and Eastern European market as part of the local privatisation process;
b. high inflation and high interest rates in the transforming Central and Eastern European region converging with the Western European economies;
c. in some cases, a spectacular offensive tool of foreign controlled banks to increase their residential market share in the banking sector, as opposed to local banks with poor FX resources.

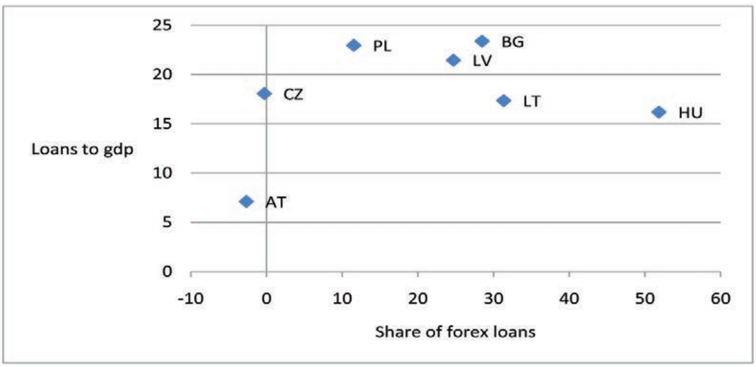
Figure 1: Share of foreign banks in EU Member States (June 2011)



Source: Consolidated Banking Data, Statistical Data Warehouse, ECB

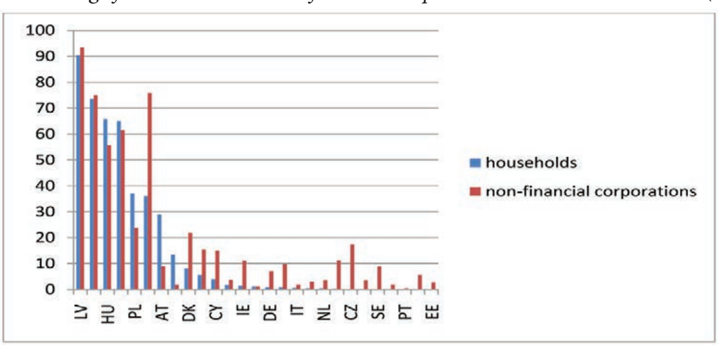
Following the Central and Eastern European privatisation process in the 1990s, a consequence of the establishment of Western European banks in these markets was that, after taking up their positions in corporate lending, they sought to expand their activities to the residential segment as well. For these foreign banks, the most spectacular method of market share acquisition (from the perspective of the banks) from the 2000s was residential foreign currency lending denominated in FX. This was mainly due to the fact that foreign parent institutions had an abundance of resources and liquidity in FX, which they happily shared with their Central and Eastern European subsidiaries. Affiliate banks were able to use those FX resources in the residential segment with a very high margin, and they were able to acquire significant parts of the market even from the best-known local players (OTP, or Pekao in Poland) since the local players were not in a good position in respect to their FX funding potential. This was true for Poland, Romania, Croatia, Bulgaria, Serbia and Hungary. This phenomenon is clearly demonstrated by the capital flow to the banking sector of these countries at the time. There is a clear correlation between the credit expansion of the 2000s and the amount of capital inflow.

Chart 2: Credit growth and forex lending in selected EU member states



Source: Balance Sheet Items, ESA95, Statistical Data Warehouse, ECB

Figure 3: Forex borrowing of households and non-financial corporations in EU Member States (February 2011)



Source: ECB, ESRB

Foreign currency lending is not specific to Hungary but is a typical phenomenon of the entire Central and Eastern European region, including Austria. However, albeit to a lesser extent, foreign currency lending also emerged in countries that did not adopt the euro such as Denmark and Sweden.

A distinction must be made between residential and corporate foreign currency lending. Through the export of goods or services, many companies can generate regular income in foreign currencies, so the repayment of a loan in a foreign currency is less problematic for them as part of their standard business operations. In contrast to this, the overwhelming majority of the population generate their income in local currency, but their liabilities may still be denominated in a foreign currency. Closely related to this fact is that a change in the exchange rate risk increases both monthly payments and the total amount of remaining debt. While some companies are able to properly handle this kind of exchange rate risk, ordinary people are typically not prepared for it.

The specificity of the Hungarian situation is that the volume and proportion of residential foreign currency lending (more precisely, its disproportionateness) was so high that it initially led to a systemic financial risk, and then to a societal risk. At a professional and decision-making forum of the ESRB (European Systemic Risk Board – European System of Financial Supervision), I described the situation as follows: *"In Hungary FX lending has become a systemic risk issue, but it has continued to slowly grow into a public policy question"*. The ESRB agreed with this opinion in every respect.

So the Hungarian specificity was that the proportion, volume and rate of growth of foreign currency lending were extremely high compared to any other European country, which not only became a risk in the banking system but also a general societal issue.

The expectations in many countries of the region before EU accession are rarely talked about now, but they were an important factor in the 2000s, and in many countries there were also political promises in anticipation of imminently joining the euro zone. This actually took place in Slovenia and Slovakia, then, a short period later, in the Baltic States, but it did not happen in Hungary and Romania. However, the approach of banks and the expectations of the population may have been rational by offering and taking loans for 15 to 20 years in the hope that the country would adopt the euro within a few years. Note, however, that this argument would have been valid only if the currency of the loans had been the euro, rather than CHF. Nevertheless, it seems to be clear that foreign currency lending has not led to any significant and long-term problems in countries that have since joined the euro zone.

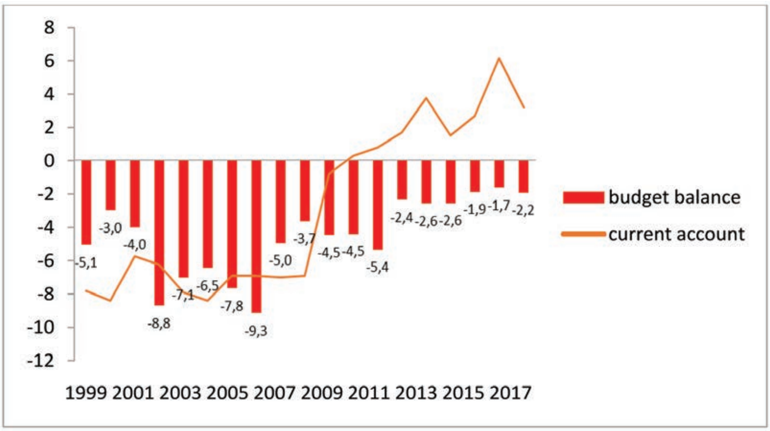
Foreign currency lending, which has become widespread in the Central and Eastern European region, has some common features in these countries: foreign currency lending emerged as a phenomenon in every country where loans with more favourable interest rates could be provided due to the interest rate difference between the national and foreign currencies. It is safe to say that the main driver of foreign currency lending was the significant difference between the interest rates of the two currencies.

Another conclusion to be drawn is that the business environment, the legal framework, and the different cultures of financial institutions could in some cases result in solutions with less damaging consequences. This might be the reason for the different weight, proportion and extent of problems of foreign currency lending from one country to another. In saying this, I have no wish to down play the problems of foreign currency lending in Poland, Croatia or Romania, but, precisely due to some specific factors, its extent and severity was far from that in Hungary at the time when the 2008 financial crisis broke out.

2. The macroeconomic environment in Hungary and other factors leading to foreign currency lending

Following the change of government in 2002, there were two fundamentally new, almost unexpected, dramatic macroeconomic developments: the budget deficit, which had been decreasing dynamically until then and was already close to the 3 per cent level, increased considerably, reaching 7 per cent, and then 9 per cent. The high budget deficit led to serious inflationary pressures. The National Bank of Hungary (hereinafter MNB), which had just shifted to a system of inflationary targeting, was forced to increase the key interest rate from 6.5 per cent to 12.5 per cent within a short space of time. Obviously, this base rate increase of 600 basis points had a direct and drastic impact on the private housing HUF loans granted by commercial banks. Almost in parallel with that, the Medgyessy Government abolished the interest rate subsidies on housing loans, introduced by the first Orbán Government.[1]

Figure 4: Budget balance and current account



Source: Hungarian Central Statistical Office, Central Bank of Hungary

Thus, as a result of the increase in the base rate and, almost simultaneously, the abolishment by the Medgyessy Government of the interest-rate subsidy mechanisms introduced by the previous Government, the actual level of the interest rates of long-term (HUF) loans for housing construction increased to 15-18 per cent. It was obviously not a rational decision for potential loan recipients to become indebted for 10 to 15 years or even longer at this interest rate.

A vacuum was created in the market as banks could not provide loans in HUF at a lower interest rate, but no one wanted to become indebted at this interest rate for 15 to 20 years. This was the

[1] Two housing subsidy programmes were running during the Orbán Government: interest rate subsidies on loans financed with mortgage deeds and additional interest rate subsidies. Without describing the system in detail, let me just point out that the maximum interest to be paid by the borrower fell to 6 per cent in autumn 2001. The sytem was succesful: Banks provided mortgage loans amounting to 493 billion HUF in 2002 and as much as 825 billion HUF in 2003.

vacuum that was filled by foreign, mainly Austrian, banks already present in the domestic market from 2003 or 2004, which introduced euro- (EUR) and Swiss franc- (CHF) denominated loans into the domestic retail market. The nominal interest rate of such foreign currency loans was 3-5 per cent.

At that time, there was abundant liquidity in Western Europe, and it seemed to be an exciting and attractive idea for bank managements to bring the CHF product, already tried and tested in Austria, to the Central and Eastern European region, where the western margin could almost be doubled. This was another method for them to take advantage of the opportunity of profit maximisation offered by the abundance of liquidity.

Prior to the emergence of foreign currency loans, OTP dominated the Hungarian market for private housing loans. Together with cooperative savings banks, OTP had a market share of nearly 80 per cent. Unexpensive funding in contrast to foreign banks, OTP and cooperative savings banks did not have a cheap source of foreign currency for the introduction of EUR and/or CHF products. This means foreign banks wanted to take advantage of the situation created by additional inadequate economic policies not only for profit maximisation, but also to acquire an actual market share. This could help them to reduce the market share of Hungarian banks, and thus gain a larger segment of the Hungarian market for themselves. And they succeeded: Following the introduction of CHF products, by 2007, the combined market share of ERSTE, Raiffeisen, Unicredit (Bank Austria) and other foreign banks (e.g. CIB) increased spectacularly, mainly was funding of OTP. Although, after a while, OTP was forced to enter the competition with CHF products, foreign resources were much more expensive for them than for their foreign-owned competitors.

Figures 6 and 7 perfectly illustrate that foreign banks used the vacuum created by the extremely high interest rates of HUF mortgage loans quite deliberately and aggressively to actively increase their market share by providing CHF-denominated loans. Between 2003 and 2010, their loan portfolio increased nine-fold, and the amount of CHF-denominated loans rose from zero to HUF 3,200 billion. Simultaneously, the market share of foreign-owned banks in the market of residential loans increased from approx. 28 per cent to almost 60 per cent during the same period.

Figure 5: Expansion of foreign banks on the Hungarian household loan market (billion HUF)

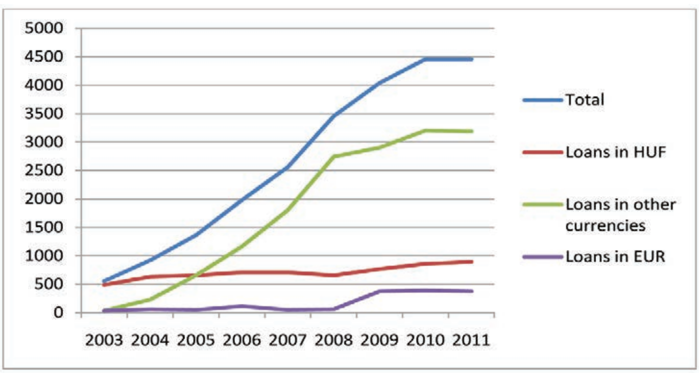
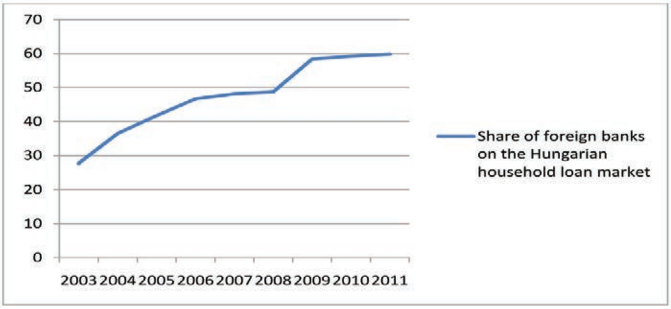


Figure 6: Share of foreign banks on the Hungarian household loan market



Because the sale of CHF credit products was extremely profitable for banks, it took place amidst ever fiercer competition. Furthermore, foreign currency-denominated credit products were increasingly sold through the intermediation of credit agents, often very aggressively. Due to short-term profit interests and high commissions, the sale of credit products was not only aggressive, but also often coupled with misleading, or even deceptive, sales practices. Therefore, CHF mortgage loans were taken out by a large number of people even if they did not really need them. Moreover, those who actually needed such loans for housing purposes could hardly find anything else in the product portfolio of banks in 2005 other than CHF-denominated mortgage loans. Lending conditions were gradually eased, and the loan-to-value ratio required by banks became increasingly lower, while the rules covering borrowers' income became increasingly lax, and in some cases were even abolished altogether. Worthy of note is a well-known advertisement by one of the commercial banks. The bank's advertisement stated: *"… We do not care how much you earn, we are only interested in the value of your property!"* The methods of irresponsible lending by banks at that time could hardly be better illustrated.

The profit level of mortgage loan products for housing purposes was so high that the affected banks soon entered the market with their Swiss franc-denominated home equity loans as well. This new credit product was used by many borrowers to buy consumer goods or to travel abroad. The aggressive and misleading sale of bank loans tempted consumers, who otherwise did not want this type of loan, even more aggressively to pledge their residential properties, and on a CHF basis.

Looking back, the question seems to be justified: where were the risk managers of banks? How could the internal risk management rules of that time allow bank managers to approve such loans under the principle of prudent lending? The absurdity of the issue is also illustrated by the fact that the mortgage loan, which had been used for decades as a product for the purchase of residential properties, was transformed into a credit product for luxury or premium consumption. As early as 2008, 70 per cent of residential mortgage loans were already being used for consumer goods. This clearly indicates the degree and irresponsibility of competition between banks in the residential market and the extent to which borrowers were unprepared and deceived when they pledged their residential properties for premium consumer items or any other purpose not related to housing.

Furthermore, the CHF schemes developed in the field of car financing, which had been used in Hungary since the late 1990s, also posed serious prudential and consumer risks. In international practice, car financing typically requires an own risk of 30-50 per cent, and the loan for the remaining amount is provided for 3 or a maximum of 5 years. Hungary was first characterised by car loans without an own risk, and then those were provided for 7-10 years. This scheme can hardly be regarded as prudent from a financial point of view because an 8- 10 year-old vehicle cannot provide realistic coverage due to its loss of value over time.

3. Regulatory issues, response from the authorities, or the lack of it

During the period concerned, between 2004 and 2009, there was practically no action by the authorities, regulation or supervisory intervention whatsoever in Hungary in favour of consumers. As a rare example, the 2003 Annual Report of the Hungarian Financial Supervisory Authority (HFSA) drew attention to the prospective risks of foreign currency lending, which was insignificant at the time (3 per cent) but had alarming dynamics. However, the political response was clear: In the first half of 2004, the HFSA was transformed through an infamous act called Lex Szász, and the entire management of the financial supervisory authority was dismissed. The independence of the supervisory authority, previously guaranteed by law, was circumvented by abolishing the position of the president in the authority and creating a new decision-making body (the Supervisory Board). Unlike its predecessor, the new supervisory authority is a declared government agency, reporting quarterly to the Minister of Finance, who is also entitled to provide guidance to the financial supervisory organisation.

Today, there is extensive literature on the reasons why the state, i.e. the HFSA, the MNB and the Ministry of Finance, did not intervene between 2004 and 2010, and why they did not keep the dynamically expanding market of private housing foreign currency lending under control. Several questions have been raised, such as: why they did not require more stringent risk management and stronger financial consumer protection, and why did they not incorporate adequate income and coverage standards into the system to control the huge volume of risk?

The responses of the actors of the time are mostly limited to claiming that neither the supervisory authority nor the MNB had the legal means to stop or ameliorate the process. This is, of course, only the partial truth. Nothing actually prevented the Government from setting more stringent coverage requirements or prescribing stricter checks of income in financial legislation. The supervisory authority could have set a higher capital requirement for this type of loan, making such loans more expensive and more prudent. The MNB, on the other hand, could have specified standards for the mandatory reserves of banks. However, such measures were not implemented. I will come back to the reasons later.

The alleged lack of means can be refuted with the abolishment of yen loans. In addition to EUR and CHF, Japanese yen-denominated mortgage loans also emerged, mainly in the product range of two banks. The Japanese yen was at that time characterised by significant volatility, as well as by rapid and abrupt exchange rate fluctuations, so the response threshold of the MNB experts and the supervisory authority had already been reached by this phenomenon. A few months after the introduction of the product, the banks concerned discontinued the disbursement of yen-denominated mortgage loans in response to the (non-legal) joint action of the supervisory authority and the MNB. This fact also indicates that, if there had been sufficient recognition and will after 2004, the MNB and the HFSA could have easily decelerated the rapid proliferation of CHF loans and could have applied the brakes at any time. As we know today, they did not.

The question therefore arises, what could the reason for the “laissez-faire, laissez-passer” approach adopted and maintained until 2009. When seeking an answer to this, the starting point should be the fact that the performance of the Hungarian economy at the time of the rise of foreign currency loans was miserable: From 2006, economic growth had started to slow down sharply. This fall was so drastic that GDP grew by only 0.4 percent in 2007 and 0.9 per cent in 2008. At that time, there was still no sign of a crisis in Europe; quite the opposite: the money market sentiment was buoyant, there was an abundance of money in the markets, and world trade was soaring. Even the slightest deceleration of the domestic credit market, which was still growing rapidly, could have had a boomerang effect, mainly in the construction industry. In that period, the Hungarian construction industry – precisely as a result of dynamic lending – produced 35 to 40 thousand new homes annually. The deceleration of lending would clearly have led to an almost immediate fall in GDP growth, which was already quite low. Obviously, because the crisis emerging in autumn 2008 had not been anticipated by anyone in Hungary (and even those who anticipated it said that, “only the side wind of the crisis of the west will affect Hungary”), all the decision-makers wanted to keep GDP stable. Therefore, there was not the slightest intention to decelerate, or even to exercise stronger control over domestic foreign currency lending, which was growing dynamically and posed increasing risks.

Another dilemma also needs to be mentioned. It is frequently asked why the Hungarian population became indebted in CHF. Or, more precisely: why Hungarian banks granted their loans in CHF (and not in EUR)? The answer on the behalf of banks is clear: due to the different levels of inflation, CHF loans could be sold at a nominal interest rate of 1.5-2 per cent below that of the same loan in EUR. Obviously, this seemed to represent a more attractive option for those borrowing housing loans. Fierce market competition and the all-important pressure to increase market share forced banks and credit intermediaries to exploit even the slightest short-term advantage. The Hungarian economy was linked to the euro and the euro zone in myriad ways already by the 2000s, and until 2006 political actors also continued to make promises that the euro would soon be introduced. It was precisely after the huge budget deficit of over 9 per cent in 2006 that the then president of the MNB declared at a conference in Vienna that Hungary had little chance of joining the euro zone before 2014.[2] There were countries such as Croatia, where banks, and the public, adopted a more rational approach, and, in addition

2 Of course, Zsigmond Járai, the then president of the MNB, did not anticipate the imminent financial crisis and the resulting crisis of the euro-zone, which lasted for many years.

to CHF lending, EUR lending was also significant. The irrationality of CHF lending is also illustrated by the fact that, although the MNB had considerable foreign exchange reserves at that time, the reserves mainly consisted of EUR and, to a lesser extent, USD. However, they contained no CHF at all. In other words, the MNB actually failed to provide coverage for a serious exchange rate risk in the event of an emergency.

From time to time, the question is raised in the media, and partly also in the literature: What is the root cause of the possibility of foreign currency lending in Hungary? The first Orbán Government is often blamed for allowing the emergence of foreign currency loans by closing the foreign exchange liberalisation process and abolishing the last restrictions by law. But the reality is quite different.

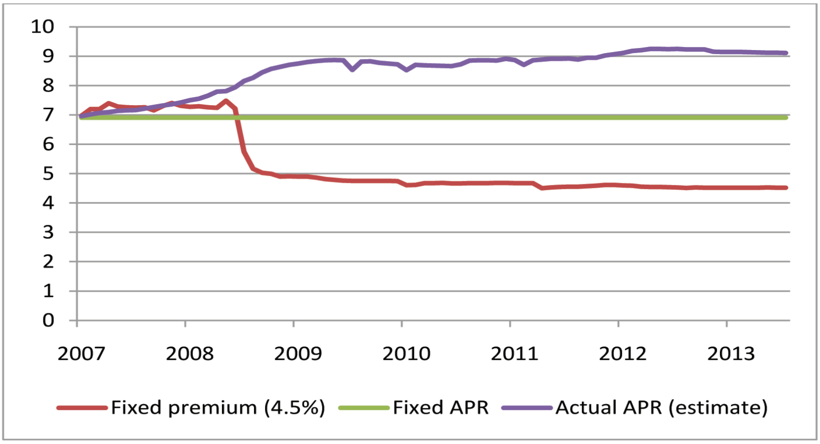
When joining the OECD in 1996, Hungary undertook, with a few exceptions, to fully liberalise the regulation of foreign exchange operations by 2001. At the time of the OECD accession in 1996, Hungarian commitments were legally proclaimed by the National Assembly. Hungary was also obliged to take this foreign exchange liberalisation measure due to its imminent EU accession. This resulted in the annulment of the previous foreign exchange act in 2001, which automatically enabled a number of foreign exchange operations, including the provision of residential foreign currency loans.

The elimination of previous legal constraints led to the same degree of liberalisation of current and capital operations as in other EU and OECD Member States. Accordingly, it would not have been possible to either prohibit or prescribe a separate licence for foreign currency lending due to both OECD and EU regulations. It is no coincidence that the problem of foreign currency lending was by far not limited to Hungary in the 2010s, since several other EU Member States were also affected. This does not of course mean that it would have been impossible to decelerate, or even stop, the proliferation of foreign currency lending by various prudential and other means when the volume of foreign currency loans and the associated risks reached a level that was already dangerous for the national economy.

4. Some Hungarian peculiarities of foreign currency loan contracts

One of the peculiarities of contracts related to foreign currency-denominated mortgage loans was that they allowed banks to alter interest rates and other charges unilaterally. This feature increased the dominance of banks in an already highly asymmetric bank-customer relationship. As a result, on the one hand, consumers (households) were exposed to an increase in payment due to exchange rate fluctuations, and, on the other hand, to a unilateral modification of contractual terms by banks. Several unilateral increases in interest rates also played a significant role in the increase of payments in the case of long-term mortgage loans. In 2005 to 2006, clients already typically took out loans above an annual percentage rate (APR) of 6-7 per cent. This included a surcharge of about 5 per cent by banks compared to the CHF reference rate (CHF LIBOR). In the case of contracts already signed, banks unilaterally increased the APR by another 2 per cent to 8-9 percent during the crisis, thus significantly increasing monthly payments.

Figure 7: Annual percentage rate (APR) of a typical Swiss franc-based mortgage loan in different scenarios



Source: MNB (Central Bank of Hungary)

Another peculiarity of Hungarian foreign currency lending was that banks used different selling and buying rates of exchange for the disbursement and for the repayment of loans. This can also be explained by the dominant position of banks. As a result, the banks realised some additional exchange gain when the loan was repaid by the borrower. They were allowed to do so until the end of 2010. However, in autumn 2010, the new Government prohibited this practice, requiring banks to use the medium rate.[3]

5. Recognising the problem, moving towards solutions

It was only after the outbreak of the crisis in 2008 that decision-makers first recognised the close connection between the problem of foreign currency lending and the crisis of the economy, more specifically a significant increase in unemployment and changes in the situation of borrowers (e.g. job losses). All this represented a serious credit or repayment risk, a part of which had already been realised. For reasons already mentioned above, the payments borrowers had to make were constantly increasing, just like the difference between foreign exchange rates, and banks used higher and higher interest rates (surcharges). An increasing number of borrowers were unable to pay the ever-increasing monthly payments, because the incomes of their families also fell significantly. This was the time when policy-makers actually directly faced the enormous risk of foreign currency lending accumulated over the years, as well as the serious challenges to families, which resulted in a spectacular increase in the rate of problematic loans and, even more, non-performing loans. Non-performing loans represent a problem for banks, or even the entire banking system, as they require special provisions, which significantly lower their profit levels.

[3] In contrast, in Serbia only the medium rate could be used for both the provision and the repayment of the loan.

Problems gradually became more than just banking difficulties. Within a very short space of time, non-paying families fell into a situation where mortgage enforcement, or even eviction, already posed a real threat to them. The more such individual, family problems there were, the more obvious it was that all this would lead to social tensions, which needed to be handled by the authorities in some way.

In 2009, it was recognised that there was no institution or authority in Hungary that could take legitimate action for the protection of financial consumers in order to handle the vulnerability of consumers created by foreign currency loans. Basically, the legislative bodies authorised the Hungarian Financial Supervisory Authority by providing a legislative mandate for prudential supervision and the supervision of financial market processes (market surveillance). Until the outbreak of the crisis, supervisory authorities were traditionally responsible for the stability of the financial system and institutions. At that time, such bodies did not have express authority over financial consumer protection in Europe. It was the crisis that led to a situation where financial supervisory authorities received a role in consumer protection. Hungary was one of the first European countries where this change took place. In 2009, the Hungarian Financial Supervisory Authority was completely reorganised, new legislation was passed, the former management left the organisation, and, with one-person management, the supervisory authority now had a President again instead of a collective decision-making body. This decision in itself indicates that the then Government implicitly admitted the operational inability, incapability and incompetence of the former Supervisory Council with respect to recognising and managing the risks of foreign currency lending in a timely manner.

Thus, from 1 January 2010, the Hungarian Financial Supervisory Authority was granted consumer protection powers. This was an essential measure for the authority to start to address the issue of foreign currency lending, already affecting the entire sector, and to mitigate the problems of consumers and the population. All of this enabled the authority, sooner or later, to manage the systemic risk, already present at that time, in some form or other.

6. The measures of the new Government, the problems of foreign currency loans from 2010

One of the first measures of the second Orbán Government, established in 2010, was to replace the management of HFSA and to appoint a dedicated Vice President in charge of specific financial consumer protection issues. The first strategic task of the supervisory authority was the assessment of problems and the preparation of short- and longer-term proposals to mitigate the situation. A separate directorate was formed to manage and process consumer protection issues, to examine individual submissions already reaching a magnitude of tens of thousands, and to find solutions. The existing legal framework also had to be examined in the same way. One of the key questions was where brakes had to be applied in the legal environment in effect at that time.

One of the first measures of the Orbán Government was to de facto ban residential mortgage loans. This was not a complete ban de jure as those natural persons who had regular income in a foreign currency and whose monthly income was at least fifteen times the monthly payment were still entitled to take out foreign currency loans. This condition was of course so strict that only very few private individuals had access to foreign currency loans, and the act actually put an end to the disbursement of new foreign currency loans in Hungary in the summer of 2010.

Incidentally, a total ban would also not have been possible because Hungarian legislation is based on the EU Directive on consumer credit.[4] Of course, the prohibition of the provision of new foreign currency loans did not solve the problem in itself, but at least prevented further growth in the volume of loans.

Upon a proposal of the supervisory authority, further legislation was adopted in 2010.[5] According to the new law, in the future only the medium rate could be used for the calculation of payments. In addition, the law reduced the prepayment charge, or maximised the charge at that reduced level. The law prescribed a free-of-charge procedure for borrowers able to make a final repayment or a higher-amount prepayment on their loans. As another important element of the law, credit institutions were limited in unilaterally amending their contracts. In this respect, the law stipulated that the credit institution was no longer allowed to change the contract unilaterally to the disadvantage of the borrower. This could only be done in a way that was beneficial to the consumer. Furthermore, borrowers in dire straits were allowed, on a single occasion, to request the extension of their credit contracts for a maximum of five years. The creditor could not deny such a request, and the amendment of the contract was free.

Subsequently, the Government and the National Assembly adopted further measures to mitigate the problem for foreign currency borrowers. In autumn 2011, the final repayment of foreign currency loans was allowed under very favourable conditions. Within a few months, approx. 170 thousand borrowers had exploited this opportunity. The debt thus released was about HUF 370 billion, while the total amount repaid was HUF 1,355 billion. As a benefit for borrowers, it was possible to repay Swiss franc-based debts at a rate of HUF 180, instead of the official CHF exchange rate of around HUF 250. In the case of euro-denominated loans, the foreign currency loan could be repaid at a rate of HUF/EUR 250, while a discounted rate of HUF/JPY 2 was used for Japanese yen. Banks could deduct up to 30 per cent of their resulting losses from the bank tax. The average amount of repaid loans was HUF 5.8 million, based on the fixed final repayment rate. Anyone could opt to make a final repayment by 30 December 2011. The availability of coverage for final repayment had to be confirmed by 30 January 2012, and the loan had to be settled by 28 February 2012 at the latest. The measure was all in all successful, significantly reducing both the number of foreign currency borrowers and the volume of foreign currency loans. Nevertheless, it was only a single step in the management of all the problems. On 30 September 2011, there were 750 thousand foreign currency mortgage loan borrowers, compared to only 560 thousand on 31 March 2012. The volume of foreign currency mortgage loans decreased from HUF 5,600 billion on 30 September 2011 to HUF 4,245 billion.

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4 Directive 2008/48/EC on consumer credit agreements, transposed into Hungarian law by Act CLXII of 2009 on consumer credit.

5 See Act XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in a difficult situation due to taking out housing loans (promulgated on 28 October 2010)

A so-called "exchange rate cap" was introduced in September 2011 to mitigate the effects of exchange rate fluctuations. The exchange rate cap was aimed at temporarily dampening the effects of exchange rate fluctuations, so the repayment exchange rate for foreign currency-denominated mortgage loans was fixed for five years. This fixed exchange rate was HUF/CHF 180 for Swiss franc-denominated loans, HUF/EUR 250 for euro-denominated ones, and HUF/JPY 2.5 for loans denominated in Japanese yen. Borrowers who opted in were also granted debt relief. The interest part of the deferred debts of clients choosing the exchange rate cap was taken on by banks and the state budget at 50–50 per cent. Clients choosing the exchange rate cap were exempted from the payment of interest amounting to approx. HUF 60 billion. About 186 thousand foreign currency borrowers had entered into such contracts by the end of 2014.

According to the legal regulation, after the 5-year fixed period of the exchange rate cap, a further limit was used to protect consumers when including in the payment the amount accumulated as a result of the exchange rate cap, recorded in a separate account. Pursuant to this limitation, the payment could not be increased by more than 15 per cent. In terms of figures, 15 per cent of the average payment (approx. HUF 56 thousand) was not more than HUF 8,400 per month.

In addition, the Government protected borrowers in the most difficult situations with an extraordinary eviction moratorium in effect until 16 September 2015, preventing the auctioning of their residential properties and the loss of borrowers' homes.

As a result of another government measure, the National Asset Management Company was launched in 2012. The National Asset Management Company was established to help the socially most deprived borrowers. They purchased the property of borrowers for the state, but the erstwhile borrowers could still remain in the property as tenants for rents much lower than the market price. In addition, the creditor banks released the borrowers' outstanding debts from mortgage loans. The National Asset Management Programme was based on a joint effort by the Hungarian state and the banks. The state supported the purchase of homes with substantial budgetary resources, while banks put up with losing a significant part of the affected loans to support the programme. The amount of rent was regulated by a government decree on a mandatory basis. The law also guaranteed the right of repurchase: Borrowers were entitled to repurchase their homes if their financial situation improved. The borrower was able to apply for an interest subsidy for housing loans to repurchase his or her home.

The programme was originally planned for three years, but was later extended: The National Asset Management Company purchased 25 thousand homes by the end of 2014. By the end of 2018, 36 thousand residential properties had actually been taken over by the asset manager, so approx. 150 thousand people were affected by this kind of state aid. Based on authorisation by the Government, the National Asset Management Company had accepted offers for the purchase of more than 42 thousand properties by 31 May 2018, and financial settlement with the borrowers was still partly in progress at the end of 2018.

7. The complete phase-out of foreign currency loans and settlement with banks

Despite a number of Government measures providing a great deal of help to borrowers, in 2014 it was already obvious that a comprehensive solution had to be found to settle the situation of foreign currency borrowers both definitively and reassuringly. The solution had to simultaneously provide an opportunity to the banking system to break out of an endless spiral. The increasing number of non-performing loans severely worsened the profitability of the banks and lowered their lending capacity. This was to the detriment of the real economy.

The solution had to be based on insight into an extremely complex legal framework, and the room for flexibility had to be clarified. Furthermore, legislative changes to a large number of civil law contracts raised questions regarding constitutionality, and the reliance of consumer credit regulations on EU legislation also had to be taken into consideration.

In addition to legal complications, some fundamental economic policy issues also came up. It was only possible to even consider the HUF conversion of foreign currency loans in a healthy banking system, with stable macroeconomic foundations, proper equilibrium indicators, and much lower HUF interest rates than at the time of taking out the loan. The inadequate timing of settlements and the phase-out of foreign currency loans could even have been harmful to borrowers.

Therefore, the decisions of the Constitutional Court of 28 February 2013 and 24 March 2014 represented a true milestone. Based on the interpretation of the Constitutional Court, the National Assembly could exceptionally change the content of civil law contracts if the borrowers' homes were at risk or in the event of an abuse of a dominant position by credit institutions. Furthermore, on 30 April 2014 the European Court of Justice decided (because of the involvement of the relevant EU Directive) that Hungarian courts were also entitled to investigate the unfairness of foreign currency loan contracts. Subsequently, in its uniformity decision of 16 June 2014, the Curia declared that the legal answer to the question raised by many in thousands of lawsuits was that the exchange rate proliferation was unfair in all foreign currency loan contracts. The Curia also concluded that, in the absence of proof to the contrary, the unilateral contract amendments for residential loans by banks did not meet the requirements of fairness.

The decision of the Curia in June 2014 gave a legal opportunity to the National Assembly to provide a comprehensive solution to the problem. The decision of the Curia created a special situation: hundreds of thousands of borrowers felt encouraged to sue based on the uniformity decision, in the hope of sure success. However, such a large number of legal actions would have completely paralysed the Hungarian judicial system, and the plaintiffs would have had remedy only after many years. The Government therefore decided that the issue should be dealt with and resolved at a legislative level, and the act adopted in July 2014, based on the uniformity decision of the Curia, declared the nullity of the contractual clause on the application of the exchange rate proliferation and made a presumption regarding the unfairness of clauses on unilateral contract amendment.[6]

[6] Act XXXVIII of 2014 on the resolution of questions relating to the uniformity decision of the Curia regarding consumer loan agreements of financial institutions.

During 2015, banks were required by law to settle accounts for the refund of overpayments due to the unfair exchange rate proliferation and unilateral contract amendments with those clients who had taken out a foreign currency loan with them. In the course of the settlement process, banks sent out 2.1 million letters and the refunded, credited amount came to nearly HUF 750 billion. This resulted in a significant reduction of burden for households. The amount to be repaid fell considerably, and the amount of outstanding principal also decreased, resulting in a 25 per cent reduction in monthly payments.

The repayment obligation of clients was further reduced by the fact that, from 1 February 2015, fair interest rates had to be restored for all loan contracts affected by the settlement process, which typically meant the restoration of the interest rates applied when the contract had been signed.

8. HUF conversion of mortgage loans

The settlement process, the reduction in outstanding principal achieved through the act, and the lower payments would only have been useful for the population in the long term if the exchange rate risk still present in the new situation was eliminated. This was the purpose of the act on the HUF conversion of loans.[7] The act, which entered into force on 1 February 2015, ensured the conversion of both mortgage loans for housing purposes and home equity loans. The banks converted the loans of nearly 500 thousand borrowers into HUF. It was important that the conversion should take place at market rates, in accordance with the decision of the Curia.

According to preliminary estimates, the amount of foreign currency that had to be converted into HUF was around EUR 9 billion. The question arose as to how to prevent the conversion of this large amount of money from causing serious disruption in the market, and how to keep the exchange rate stable. To avoid speculation, the exchange rates to be applied for conversion were fixed on 7 November 2014: HUF/CHF 256.47 (the average of the period elapsed since the Curia decision of 16 June 2014), HUF/EUR 309.97 and HUF/JPY 2.163 (official MNB exchange rate of 7 November 2014). Based on its agreement with commercial banks, the MNB provided the necessary foreign currency at the expense of its own reserves to ensure the conversion took place in a professional manner, without market disruption.

The HUF conversion protected the population from further significant burdens. The conversion was performed at the exchange rate fixed in November 2014, but the HUF/CHF exchange rate was already significantly higher at the beginning of 2015, because the Swiss National Bank unexpectedly abolished the CHF/EUR exchange rate cap (CHF/EUR 1.20) in the second half of January 2015.

The positive effects of the HUF conversion of mortgage loans were already visible in the short term: As a result of the exchange rate fixing at the end of December, immediately preceding the HUF conversion, the dramatic weakening of the HUF against the CHF in mid-January 2015 no longer exacerbated the payment burdens of mortgage borrowers and the risk exposure of banks. Therefore, the significant national economic risks associated with residential loans were not realised.

7 Act LXXVII of 2014 on settling certain issues related to the conversion of the currency of certain consumer loan agreements and to the rules governing interest rates

Croatia and Poland were not in such a favourable position. In both countries, indebtedness in foreign currencies, mainly in Swiss francs, was also causing serious difficulties, but the resolution to the problems of foreign currency borrowers did not progress as far as in Hungary. In Poland, payments for Swiss franc borrowers increased by more than 15 per cent, and in Croatia by nearly 10 per cent, compared to the amount payable a year before. Without the HUF conversion, the debts of citizens would have increased by approx. HUF 400 billion in Hungary too. This would have meant more than 10 per cent higher payments on average.

9. HUF conversion of other consumer loans

Residential foreign currency loans other than mortgage loans continued to be associated with an exchange rate risk. The appreciation of the Swiss franc in January 2015 raised the burden on borrowers with foreign currency-denominated consumer loans. Therefore, after the HUF conversion of foreign currency mortgage loans, the Government looked for a solution for the HUF conversion of remaining car and personal loans as well. Although the volume of such loans (HUF 305 billion) was significantly lower than that of mortgage loans, a large number of households were affected as the number of contracts exceeded 240 thousand.

On 22 September 2015, the National Assembly adopted an act regulating the HUF conversion of foreign currency-denominated car and consumer loans, which affected about 200 thousand contracts.[8] The banks and the state both took over half of the burden caused by the difference between the exchange rate used for mortgage loans in November 2014 and the exchange rate in August 2015 (HUF 15 billion each).

This measure resulted in payments of about 10-11 per cent lower. However, borrowers no longer faced exchange rate fluctuations and unpredictable monthly repayments.

As a result of these Government measures, residential foreign currency loans were virtually phased out completely in Hungary by 2016. This is also reflected in the statistics, as the share of foreign currency loans within the total volume of residential loans reached 71 per cent by 2009, while it dropped to less than 1 per cent by the beginning of 2016.

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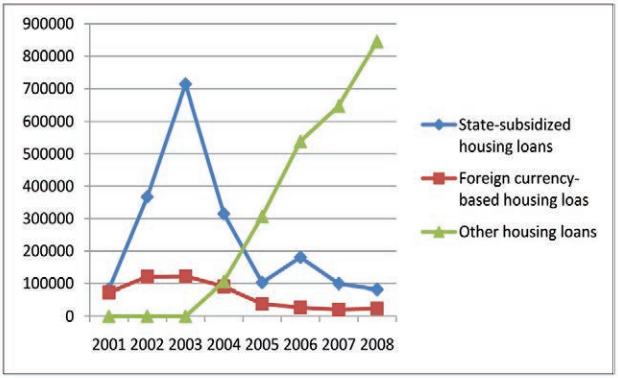
[8] Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables arising from certain consumer loan contracts.

ANNEX

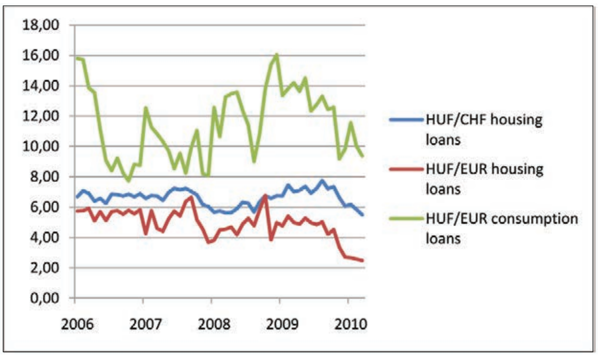
Background tables

Amount of housing loans granted in the reference period (in HUF million)



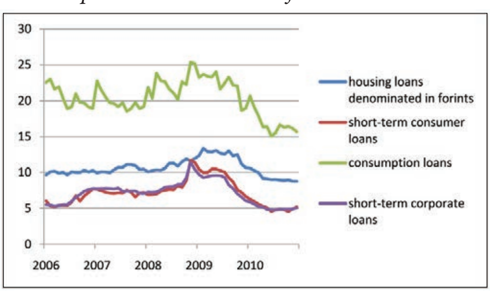
The development of the average interest rates on foreign currency mortgage loans for housing purposes for new and existing contracts in Poland, Hungary and Romania (*source: MNB*)

Interest rate of loans denominated in forints, euros and Swiss francs



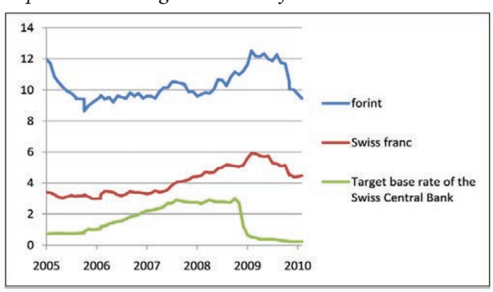
Trends in interest rates

Average interest rates of bank loans and deposits denominated in forints



Source: MNB, Central Bank of Hungary

Interest of forint- and Swiss franc-based housing loans compared to the target base rate of the Swiss Central Bank



Source : MNB, Central Bank of Hungary

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IT'S ALL ABOUT TIMING – ON THE CONVERSION OF FOREIGN CURRENCY BASED LOANS

The government and the Hungarian Banking Association signed the agreement on the conversion into forints of foreign currency based household mortgage loans on 9 November 2014. This was followed on 25 November 2014 by the adoption by Parliament of Act LXXVII of 2014 on the settlement of issues related to the conversion of the currency of certain consumer loan agreements and rules regarding interest (the so-called Settlement Act). Pursuant to the Settlement Act, the financial institutions were required to convert foreign currency-based loan agreements until 31 March 2015. When defining the monthly instalments however, as of 1 January 2015, they were required to apply the fixed exchange rate determined in legislation (EUR: 308.97 HUF, CHF: 256.47 HUF, JPY: 2.163 HUF).
This overview will evaluate regulatory measures necessary to ensure the conversion into forints of the foreign currency based loans by examining the timing and the method of conversion as well as comparing the Hungarian experience with that of other countries of the region.

1. The Timing of Conversion

When assessing legislative intervention targeting the conversion of foreign currency based loans, it is appropriate to identify the legal and economic conditions without which the measures could not have been successfully implemented. In doing so, one should also consider when these conditions emerged.

1. 1. Legal environment

- Civil Law Uniformity Decisions 6/2013 ('6/2013 PJE') and 2/2014 ('2/2014 PJE') of the Curia offered clear guidance on the treatment of the exchange rate margin and of the unilateral amendment of contracts. They served as a key reference for legislation that eventually paved the way to conversion.
- Parliament followed up Decision 2/2014 PJE by adopting Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of consumer loan contracts entered into with financial institutions and later Act XL of 2014 on the rules of settlement regulated in Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of the consumer loan contracts entered into by financial institutions, and certain other provisions.
- Additionally, Decision 6/2013 PJE of the Curia also held that the fact itself that the exchange rate changes burden the debtor in exchange for the more favourable interest rate does not render the foreign currency based loan contract arrangement unlawful, obviously immoral, usurious or sham, nor is the contract aimed at impossible services. This was also confirmed by Decision 2/2014 PJE which stated that the clause of a foreign currency based loan contract which stipulates that the risk of foreign exchange rate shall be taken without restrictions by the consumer – in exchange for a favourable interest rate – forms part of the main subject matter of the contract, therefore, as a main rule, its unfairness is exempt from assessment. The decisions passed down by the Curia with regard to exchange rate risks had clarified that conversion was to take place at market rates prior to the adoption of the Settlement Act.

1. 2. Economic environment

- By the end of 2014 the National Bank of Hungary ('MNB') was able to provide sufficient foreign currency for the purposes of conversion into forints owing to a favourable constellation of the volume of foreign currency based mortgage loans (EUR 9 billion), the foreign reserves of the MNB (EUR 35-37 billion) and short term external debts (EUR 21 billion). Whereas in previous years the foreign currency reserves were at the same level (from 2010 EUR 35+/- 4 billion), the volume of foreign currency based loans was larger (peaking at EUR 19 billion) and the short-term external debt higher (between 2010-2012-ben EUR 35-38 billion).
- The initiative could only succeed if it could be ensured that conversion into forints would not entail the increase of instalments for the customers. Reasonably, the total cost in forints could not exceed the total cost in foreign currency before conversion. As a result of the interest rate reduction cycle, the 7% base rate applicable in the summer of 2012 dropped to 2.1% by the autumn of 2014, which was closely followed by the decrease of the 3-month BUBOR. Owing to the decline of BUBOR to 2.1%, the gap between the cost of borrowing funds in forints and Swiss francs diminished significantly, the banks did no longer need to face further considerable losses after write-offs associated with settlement made in accordance with Act XL of 2014.

With the hindsight of four years, we can state that the timing of the conversion as well as the legal and economic conditions were ideal as all the ingredients had come together by the end of 2014 to implement the measures with success. As for timing, it should be stressed that the conversion of loans into forints applied from 1 January 2015 protected the customers and the financial sector from the hardly foreseeable negative economic consequences of the 2015 exchange rate shock.

2. Conversion: Its Impact on Customers, the Banking Sector and the National Economy

Economic actors believe that the conversion of foreign currency based loans into forints represented one of the most impressive measures taken by the central bank and the government, moreover both the design and the implementation were correct. The benefits of conversion are enjoyed by customers owing to smaller burdens, by the banking sector owing to the mitigation of credit risk and to the strengthening of financial stability as well as by the national economy through its reduced vulnerability.[1]

[1] On the impact of conversion see: KOVÁCS Levente: *Pénzügyi szektor a bizalmatlanság árnyékában*. In: KOVÁCS Levente – SIPOS József (ed.): Ciklusváltó évek, párhuzamos életrajzok. Arcképek a magyar pénzügyi szektorból, 2014-2016. Magyar Bankszövetség, Budapest, 2017. 16.

2. 1. MNB's foreign currency sale program prevented the further weakening of the forint

The MNB realized that the required amount of foreign currency (EUR ~9 billion) could not be obtained through market transactions as that could have evere repercussions on the forint's exchange rate. According to a study published by the experts of the MNB[2], a depreciation of 30% could have been projected based on data from 2008.

To avoid this, the central bank sold foreign currency from its reserves in the value of EUR 9 billion to banks by carrying out coordinated tenders in the fourth quarter of 2014 and in January 2015. Out of this amount, around EUR 8 billion was linked to conversion (the banks were trying to hedge the net position resulting from the difference between the receivables amounting to EUR 9 billion and an impairment loss of EUR 1 billion) and EUR 1 billion was due to capital reduction resulting from settlement. The banks were required to hedge against the EUR/CHF exchange rate risk, this however did not cause any problems owing to the far broader EUR/CHF market.

The MNB took into account that the various market actors achieved closed currency positions with different methods. While some of the banks held foreign currency deposits within the balance sheet, other financial institutions used off-balance sheet swap transactions to finance their foreign currency loans. Whereas the central bank provided the first group with a facility (in a value of HUF 601 billion) that was conditional upon reducing short-term debts, those entering a swap transaction were granted a longer-term unconditional instrument in the total value of 2,216 billion forints.

2. 2. The conversion performed at the end of 2014 protected debtors from the exchange rate shock of early 2015, and the decreasing BUBOR favoured customers

- On 15 January 2015 the Swiss Central Bank abandoned the 1.2 EUR/CHF exchange rate cap, which resulted in the considerable appreciation of the Swiss franc. As opposed to the exchange rate of 256.47 CHF/HUF applied at the time of the conversion, the exchange rate exceeded even 320 CHF/HUF on 18 January 2015. Although the Swiss franc has weakened somewhat since then, the CHF/HUF exchange rate has not once moved below the 256.47 rate used for conversion. The ~285 CHF/HUF exchange rate valid at the time of writing the present review is still 11% higher than the fixed conversion exchange rate.
- In early 2015 the instalment of the average CHF mortgage loan transaction of 6.5 million forints was HUF 62,000 following settlement and conversion. Had conversion not been implemented, an average customer would have been confronted with a nearly 20% higher instalment amounting to HUF 73,000 due to the strengthening of the Swiss franc. Whereas the 3-month BUBOR stood at 2.1% at the time of the conversion, it ranged between 2-30 basis points in 2018. As a result, the HUF 62,000 instalment of the average customer was reduced to HUF 56,000 (-10%). Without conversion, the

[2] KOLOZSI Pál Péter - BANAI Ádám - VONNÁK Balázs: *A lakossági deviza-jelzáloghitelek kivezetése: időzítés és keretrendszer.* Hitelintézeti Szemle, 2015. 3. sz. 60-87.

average customer would repay his loan at an unchanged premium rate (7.1%) using the 285 CHF/HUF exchange rate, representing a 71,000 forint monthly burden. The average debtor paid 580,000 forints less between the beginning of 2015 and October 2018 owing to conversion, moreover his principal is also HUF 770,000 less than if he had opted out from conversion. The benefit realized by the average customer during this almost four-year period was therefore 1.35 million forints in case of a transaction amounting to 6.5 million forints (20.8% of the principal at the time of conversion). While the estimated total benefit with regard to the portfolio converted to forints so far is around 450 billion forints, savings are expected to reach 770 billion forints over the entire life of the credit based on the current forward exchange and data interest rates. If one calculates with the estimated forward exchange rate and interest curve, the total savings of customers might reach 1,000 billion forints.

The Experience of Other Countries of the Region

In order to put the Hungarian experience of foreign currency based lending into perspective, it is also worth examining the lessons learned in neighbouring countries. Foreign currency based lending affected the EU Member States of the Central-East European (CEE) region to varying degrees, which required different reactions on behalf of the countries.

- While Slovakia and Slovenia had entered the eurozone before the crisis (in 2008 and 2007, respectively), Bulgaria pegged its currency, the leva to the euro. Owing partly to the low interest rate of the euro, foreign currency based loans were not offered in these countries.
- In the Czech Republic as a rule it was companies that resorted to foreign currency based loans. Households got indebted in Czech crowns at lower interest rates, therefore residential foreign currency based lending has not been a substantive phenomenon.
- Although in Romania and in Croatia the indebtedness of households in foreign currency was considerable, transactions in Swiss francs represented only a small proportion of loans, most of them having been taking out in euros.
- In this respect, Hungary and Poland were the most severely affected countries: in their case the excessive foreign currency debts of the households were mainly due in CHF.

Although all the four EU-member CEE countries affected by the foreign currency based lending issue attempted to mitigate the burdens of foreign currency debtors, especially those of CHF debtors, the Hungarian solution was undoubtedly the most successful and best-timed of all.

- In Croatia it was decided in September 2015, that is eight months after the abolition of the EUR/CHF peg that loans would be converted at the EUR//CHF rate applicable at the time of borrowing. This measure, however failed due to a change of government.

- Poland virtually decided upon the nullity of the exchange rate margin in August 2016, furthermore a voluntary conversion scheme was announced. Since this did not work out, the CHF loans of Polish households continues to be high on the political agenda. There were suggestions to charge 50-90% of the exchange losses occuring in the meantime to the banks. The total volume of Polish residential foreign currency loans amounts to nearly EUR 40 billion, much of which is Swiss franc-based. Whereas in the summer of 2008 1 Swiss franc was worth only 2 zlotys, the CHF/PLN exchange rate jumped to 4.5 in January 2015 and stabilized at around 4. At the time of writing, the market rate is 3.8 CHF/PLN.
- In October 2016 the Romanian Parliament decided upon the conversion of Swiss franc transactions at the rates applied at the time of borrowing. The associated burden for the banking sector is estimated around 0.5 billion euros owing to the low share of CHF loans. While in 2008 the CHF/RON exchange rate was 2.1, it peaked in January 2015 at 4.5 and subsequently stabilized at 4-4.2.

The above shows that Hungary was the only country that took measures to address the issue before the exchange rate shock hit the economy in January 2015. Whilst Poland, which found itself in a similar situation has not come up with a comprehensive response yet.

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THE RISKS OF VARIABLE INTEREST RATES: A CASE STUDY OF MORTGAGE LENDING IN HUNGARY FROM 2004 TO 2018

We have analysed a specific foreign currency loan contract to conduct a detailed investigation on a credit structure that became widespread in Hungary, allowing banks to arbitrarily change the loan interest rate during the term of the loan. Furthermore, we have presented the Code of Ethics for banks of 2009 and the later government measures that target the settlement and the reimbursement of unethically increased interests and the regulation of the interest algorithm. Finally, we have described the risks of the variable-rate loans in the light of recent trends in the Hungarian mortgage market.

1. Introduction

The history of foreign currency lending in Hungary has already been discussed by many authors from several aspects. There will certainly be a lot of debate in the future as well about how it emerged, what motivated the players, how government interventions can be evaluated, what solutions should have been provided at that time or what we can do now to mitigate negative effects and prevent similar social crises.

In the second part of the study, we have presented a case study to illustrate the conflicts, regulatory challenges and solutions related to foreign currency-denominated loans with interest rates that are changed arbitrarily by the banks.

By now, mortgage loans are denominated in HUF nearly exclusively and the changes in the interest rates are determined by a predefined algorithm. However, even this new system contains another type of risk. In the third part, we have analysed the developments of the regulatory environment in the context of housing market trends that have been slowly evolving and becoming more and more prominent over the past eight years.

In the last part, we have derived the conclusions.

2. Variable interest rates

2.1. Loan contract

In November 2009, a Hungarian couple took out a Swiss franc-denominated mortgage loan for housing construction with AXA Bank for a duration of 25 years. The transaction interest rate was defined as follows in the loan contract:

"After the date of disbursement, during the term, the Debtor shall pay for the Loan provided by the Bank a transaction interest rate specified in the applicable Announcement of the Bank, with an initial rate of 3.45% (three point forty-five per cent), which can be unilaterally changed by the Bank. The annual transaction rate will be variable during the term after each 1 (one) year interest period"/

According to standard international financial textbooks, the interest rate of a loan can be fixed or variable (floating) or possibly inverse floating.[1] However, unilaterally variable interest rates are not part of the financial canon. The mass spread of this scheme in foreign currency lending was a Hungarian specialty – a kind of hungaricum.

In the contract reviewed, it was not only the interest rate but also some non-negligible handling charges that could be changed unilaterally as outlined below:

[1] BREALEY – MYERS, 2005. 765., and BODIE – KANE – MARCUS, 2005. 485., 491., 493.

"After the date of disbursement, the Debtor shall pay for the Loan provided by the Bank a monthly handling charge, which can be unilaterally changed by the Bank, with an initial rate of 1.9% (one point nine per cent)".

The loan contract specifies in detail the "cause and effect conditions" whose variation may affect the elements of interest, fees and costs, such as the yield on government bonds and mortgage deeds, capital and money market interest rates, the central bank base rate, interbank credit interest rates, costs of funds of the creditor, country risk reflecting Hungary's politico-economic situation, costs of the credit and operational risks of the bank, with special regard to the risk of residential loans, a reduction in the creditworthiness of clients, a deterioration in the rating of debtors or in their solvency, unemployment rate, the value of the collateral, mandatory rules for reserves, operating costs of the bank, office rental fees, marketing costs, gross average salaries in the financial sector, postal and distance charges, legislation, consumer price index, tax, etc.

As can be seen, the list contains a number of risk elements that are directly related to neither the given loan nor the existing mortgage loan portfolio of the bank (e.g., marketing costs and consumer price index). The factors listed are only reference bases, which are not defined in more detail (e.g., there are thousands of market rates of interest), and whose weighting is completely arbitrary, as you can always find both favourable and unfavourable trends. Most of the factors listed are not risks, but rather uncertainties, which cannot be quantified, priced or covered. Moreover, they are related to business/strategic/entrepreneurial decisions of the bank (e.g., country risk, increase in the operating costs of the bank). There is no algorithm whatsoever for their exact relationship with the interest rate and the handling charge. Consequently, if there are favourable conditions, nothing forces the bank to reduce the interest and other costs of the loan.

Therefore, in case of such a scheme, the debtor is highly vulnerable, as the lender is not restricted in any way from increasing interest rates and charges. Hence, it is reasonable to ask: how could the consumer protection authority allow the spread of such contracts and why did the clients sign them?

2.2. Code of Conduct for banks

In autumn 2009, the Hungarian Financial Supervisory Authority (HFSA), the Hungarian Banking Association and the Hungarian Competition Authority developed a document named "Code of Conduct for Banks" (MK, 2010). The Code of Conduct was designed to regulate the lending practices of banks, particularly with respect to contract amendments (e.g., interest rate increases), the obligations of banks to provide information (e.g., verbally) and the rules of banking procedures (e.g., what to do if a client fails to pay). The Code of Conduct defined professional standards in the spirit of transparency, regularity and symmetry, and the banks who adopted the Code of Conduct could voluntarily comply with it in addition to the legal regulations in force.

This means the Code is a "soft" means of regulation – similar to regulatory recommendations and supervisory influences – which play a key role in the field of finance as well.[2] In addition to compliance with laws and regulations, professional guidelines and self-restraint may be necessary, as the reality is highly complex, and the legislator cannot take everything into account. According to Tirole, the maximisation of shareholder value can be abandoned in

[2] Dömötör – Miskó, 2016.

favour of socially responsible corporate governance when the legal system does not function properly and/or it is difficult to enforce contracts. However, he also notes that the maximisation of shareholder value is perfectly compatible with long-term social goals in many cases.[3]

According to MK (2010), unilateral changes in interest rates were still allowed, but banks had to fix their pricing rules in the so-called "Pricing Principles." With reference to business secrets, the Pricing Principles did not have to be made public; it was enough to make them available to the HFSA. It was an important step forward that a list of reasons had to be published. These reasons could not go beyond those listed in MK (2010), including only changes in the legal and regulatory environment, the money market and the macro environment and the risk rating of the client. However, banks also chose to *"refrain from raising interest rates due to a change in the risk rating of clients who continuously fulfilled their contractual obligations and were not in default of payment over the term of the loan"* (MK, 2010, 1.3). Consequently, the deterioration of the client portfolio could no longer be passed on to well-paying debtors.

This means that most of the risk factors mentioned in the contract described above were not compatible with MK. In addition, the Code of Conduct also stipulated that if there was a positive change in the costs of funds or in the exchange rate, instalments had to be decreased while the charges could only be increased by the rate of inflation, and that banks had to set more favourable conditions for prepayment.

In November 2009, when the above loan contract was signed, it was already known that the majority of banks (e.g., Budapest Bank, CIB Bank, Citibank, Erste Hungary Bank, FHB Jelzálogbank, K&H Bank, Magyar Fejlesztési Bank, MKB Bank, Magyar Takarékszövetkezeti Bank, OTP Bank, Raiffeisen Bank, UniCredit Bank and Volksbank) had joined the Code of Conduct. These banks covered more than 90% of the total volume of residential loans. However, some banks, including AXA, rejected the initiative completely).

Tibor Szekeres, Director of the AXA Group in Hungary, said, "The Code imposes an unnecessary burden on lenders, although the market is already properly regulated, and there is no need for new rules in addition to existing legislation. AXA has always acted fairly with its clients... The state, rather than the banking sector, is responsible for the Hungarian crisis, which is partly independent of the global crisis … the Code is unnecessary action by the state". Mr. Szekeres also announced that AXA would initiate legal action if AXA was blacklisted for non-compliance with the Code.[4]

On the contrary, the government and professional organisations evaluated the Code of Conduct positively.[5] Prime Minister Gordon Bajnai said, *"The document was created in response to legitimate consumer needs and client complaints. The Code provides protection to clients against the naturally occurring unilateral dominance of banks and creates a predictable, balanced relationship between the client and the creditor"*. According to Mihály Patai, Vice President of the Hungarian Banking Association, "the Code will enter history and represents a turning point in the life of the Hungarian banking system". Ádám Farkas, President of the

[3] TIROLE, 2006. 56-62

[4] portfolio.hu, 2009.

[5] fogyasztok.hu, 2009.

Hungarian Financial Supervisory Authority (HFSA), expressed his hope that this would restore *"the trust that has recently been lost between creditors, i.e., banks and clients"*.[6]

Contemporary press reports suggest that banks adopting the Code were not entirely happy about the agreement as it was not completely voluntary; they rather gave way under external pressure. This is also supported by the fact that *Péter Felcsuti,* President of the Banking Association, resigned in autumn 2009, immediately after the agreement was signed. To explain his resignation, he said, *"My opinion on some strategic issues in the banking sector is significantly different from that of some of the key members of the Banking Association"*.[7]

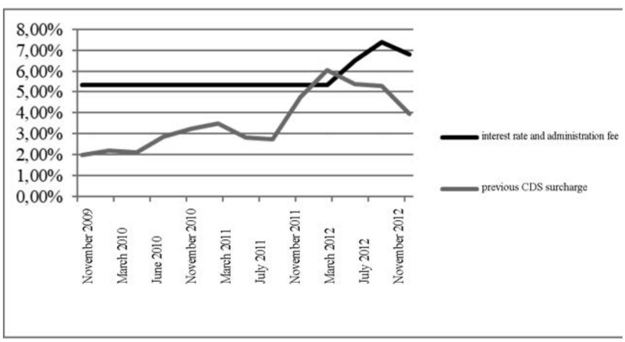
The prisoner's dilemma,[8] well known from game theory, refers to a situation where rational actors do not cooperate due to their own self-interests, and finally, the result achieved by all of them is worse than it would have been if cooperation had been facilitated. The prisoner's dilemma can be identified in a number of economic situations (e.g., evisceration of natural resources, commercial wars, Brexit, etc.), and players can pull out of this stalemate, which is unfavourable to all of them, only through external intervention. For instance, cooperation can be encouraged by "punishing" those who are unwilling to cooperate. In the context of the Code of Conduct, one of the "punishments" was to publish the names of banks refusing to adopt it in January 2010.

At that time, banks did not yet suspect that they would later face much more significant and much more costly government measures in connection with residential mortgage loans than the restrictions in the Code of Conduct.

2.3. Interest rate increases

Figure 1 shows that in the specific case under review, the bank did not increase the interest rate and the handling charges for more than two years (3.45% + 1.9% = 5.35%); however, in the summer of 2012, its prices already started to reflect the increased country risk.

Figure 1: Development of interest rates and handling charges on a CHF-denominated loan transaction



Source: Loan transaction details (MNB, 2015)

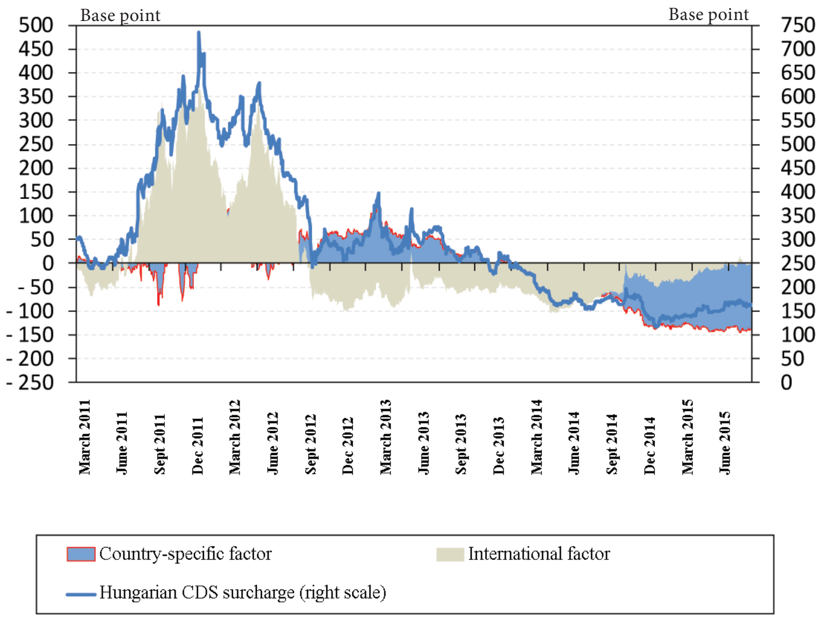
[6] fogyasztok.hu, 2009.

[7] origo.hu, 2009.

[8] See MÉRŐ, 2007.

The CDS surcharge reflecting the risk of government bonds denominated in foreign currencies, a kind of proxy for country risk that directly attributed to the financing costs of banks, had its peak between summer 2011 and summer 2012 (above 7%). Figure 2 shows the breakdown of the CDS surcharge on a country-specific basis according to international factors.

Figure 2: Decomposition of the change in the Hungarian CDS surcharge



Source: MNB (November 2015, Figure 9)

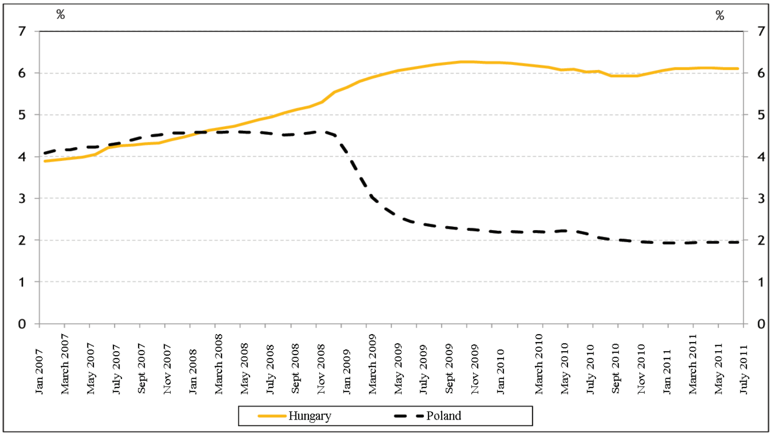
Figure 2 suggests that, in the period under review, the growth of country risk was driven by international factors rather than by country-specific effects to a greater extent. Nevertheless, AXA bank increased the costs of its loans with reference to the increase in the CDS surcharge, ignoring the fact that the interest rate as well as the exchange rate of the Swiss franc even dropped slightly at that time. This means that if interest rates and charges had been tied to the CHF exchange rate and the reference interest rate, then the costs of loans would have decreased rather than increased.

Figure 3 shows that banks had previously already raised the interest rates on CHF loans, with the largest increase in early 2009 followed by a long stagnation. All in all, the average interest rate of Swiss franc-denominated loans was a lot less favourable to borrowers in Hungary than in Poland, where variable interest rates were determined by an explicit algorithm (CHF LIBOR + fixed margin); therefore, the increase in the CHF exchange rate was compensated by a reduction in CHF interest rates.[9] *Hudecz* describes the practices of foreign currency lending in Poland, Romania and Hungary in detail.[10]

[9] KIRÁLY – SIMONOVITS, 2017.

[10] HUDECZ, 2012.

Figure 3: Average interest rates on the total volume of CHF loans in Hungary and Poland



Source: Király, Banai, 2011

This means that in addition to direct market risks, Hungarian banks also passed on their business risks in a broad sense to their clients, including international effects such as the global fall in risk appetite. This picture is further complicated by the fact that the period between 2009 and 2012 was characterised by a lot of government measures that were extremely unfavourable to banks – a special bank tax was introduced in the second half of 2010. The discounted final repayment took place at the end of 2011, and the act on the financial transaction duty was adopted in summer 2012. The discounted final repayment cost banks HUF 260 billion net,[11] and additional expenditures amounting to approximately HUF 144 billion and HUF 260 billion were created by the special bank tax and the transaction duty, respectively (2013 data).[12] These significant extra costs are also likely to have contributed to the decision of AXA Bank in the summer of 2012 to increase interest rates, as described in the case study.

Schepp and Szabó note that the increase in their costs appeared only partly in their interest rates, and they think the dominance of banks was much more manifested in the initial pricing.[13] However, *Radnai* demonstrated through model calculations that, in their own interest, banks should have decreased rather than increased the interest rates and other cost elements in this situation, as, due to the higher instalments, default rates also started to increase immediately, which had a dramatically destructive effect on their profits as a boomerang effect.[14]

When investigating residential lending in Hungary, *Balás et al.* found that default could best be explained by the payment-to-income (PTI) ratio.[15] The banks increased the interest rates

[11] KIRÁLY – SIMONOVITS, 2017.

[12] BARCZEL, 2015.

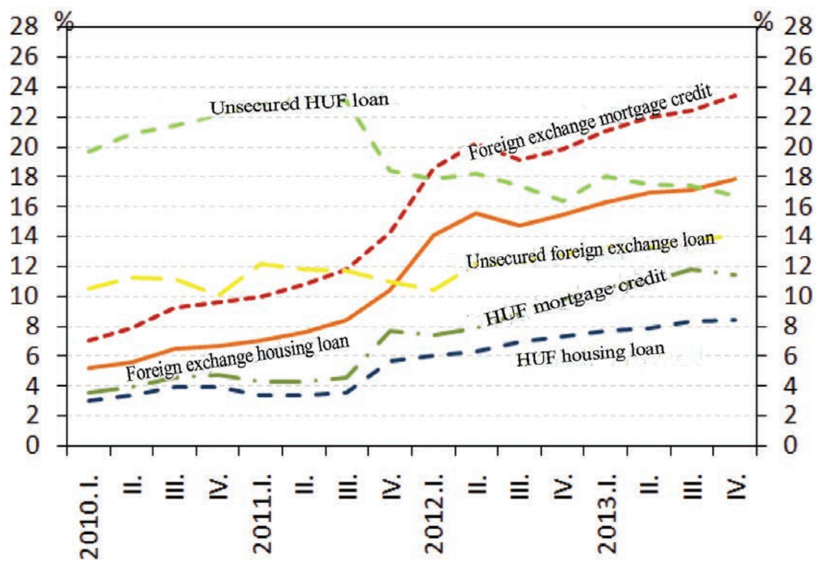
[13] SCHEPP – SZABÓ, 2015.

[14] RADNAI, 2015.

[15] BALÁS – BANAI – HOSSZÚ, 2015.

on residential foreign currency mortgage loans by 2 percentage points on average, which itself resulted in a 16.8% rise in instalments for a 20-year loan. In addition, the CHF exchange rate also increased by 55%, possibly leading to a total instalment rise between 70% and 80% (the average increase was between 50% and 60%). The situation was further exacerbated by higher unemployment, lower wages and lower real estate prices due to the crisis. As a result of all of these factors, the rate of non-performing loans (NPL) for more than 90 days gradually increased to over 22% in the segment of residential foreign currency mortgage loans, which turned into a serious systemic social problem (see Figure 4).

Figure 4: Ratio of household NPL for each product



Source: MNB (May 2014, Figure 58)

Figure 4 emphasises the risks of foreign currency loans and, consequently, the currency risk, even though unfavourable outcomes were also driven by unilateral increases in interest rates. It would be difficult to determine the exact role of interest rate increases in the drama of foreign currency borrowers, but it is likely that they contributed to the situation to a much greater extent than it usually appears in public discourse.[16]

2.4. Regulation of interest rates

The new act on transparent pricing[17] came into effect at the beginning of April 2012, stipulating that, in the case of new residential mortgage loans, banks were not allowed to charge any other interest rate-type fees or costs regularly payable in addition to the interest. Furthermore, they were also not allowed to offer a temporary discounted interest rate and,

16 KIRÁLY – SIMONOVITS, 2017.

17 Act CXLVIII of 2011.

most important for our present subject, the interest rate had to be either fixed or tied to a reference rate. In the fixed-rate scheme, at the end of the fixed interest period (3, 5 or 10 years), the bank was still entitled to unilaterally change the interest rate; however, the client was also entitled to terminate the contract and make a prepayment free of charge. This provision protects debtors, as, if the loan becomes too expensive, they can simply and quickly refinance it with another bank. If the loan interest rate was tied to a reference rate, then the interest surcharge over the reference rate (spread) had to remain fixed throughout the term according to the 2012 regulation (provided that the client was not in significant default).

After 2015, however, the interest surcharge could also be changed due to the fact that under extreme market conditions, risk premiums may increase significantly (Act LXXVIII of 2014). Additionally, the bank may modify the interest rate and interest surcharge of the loan up to 5 times during the term, up to the interest change ratio or the interest surcharge change ratio. The National Bank of Hungary (MNB) has defined various versions of both ratios and continuously publishes the current value thereof. In the case of HUF loans, a change in the reference interest rate may be based on the interest rate or secondary market yield of benchmark bonds registered by the Hungarian State Debt Management Agency (ÁKK) or on the rates of Budapest Interest Rate Swap (BIRS). In both cases, there is also a version where fiscal burdens are incorporated according to a predetermined algorithm.

The so-called "Uniformity Act" resulted in a significant change in the evaluation of variable interest rates.[18] It stipulated that contractual provisions on unilateral contract amendments did not comply with the principles of clear and understandable wording, itemised definition, objectivity, factuality and proportionality, transparency, cancellability and symmetry, and they were, therefore, null and void.[19] This created a theoretical basis for the settlement of foreign currency loans, whose framework was later determined by the Act on Settlement. [20]Settlement focused on the repayment of the so-called "unilateral interest rate increases" and the so-called "exchange rate spread" (more precisely, the reduction of debts), but only for those debtors who were not in default. The loss of the banking sector, which resulted from this measure, was larger than that from final repayment, approximately HUF 900 billion, and it definitively closed the era of unilaterally variable interest rates.

2.5. The twilight of foreign currency loans

As a result of the worsening of the foreign currency loan portfolio and related government measures (special bank tax, final repayment, exchange rate cap, transaction duty, settlement of interest and exchange rate spread), the banking sector suffered a significant loss between 2010 and 2015. Table 1 shows the after-tax income of the entire banking system, in general, and that of AXA Bank, in particular, between 2010 and 2017, thereby indicating the most important government measures.

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18 Act 2014 of XXXVIII.

19 For more details, see: BODZÁSI, 2015.

20 Act XL of 2014.

Table 1: After-tax income of the Hungarian banking system and AXA Bank (2010–2017), billion HUF

Year	Banking system as a whole	AXA Bank	Government measures	Estimated cost of measures for banks*
2010	0	–9	Introduction of special tax	144 per year
2011	–289	–37	Final repayment	Single 260
2012	–174	–16	Introduction of exchange rate cap and transaction duty	80 + 260 per year
2013	31	6		
2014	–541	–38	Settlement of interest and exchange rate spread	Single 900
2015	–29	–12	HUF conversion	100 per year
2016	442	11		
2017	629	n/a		

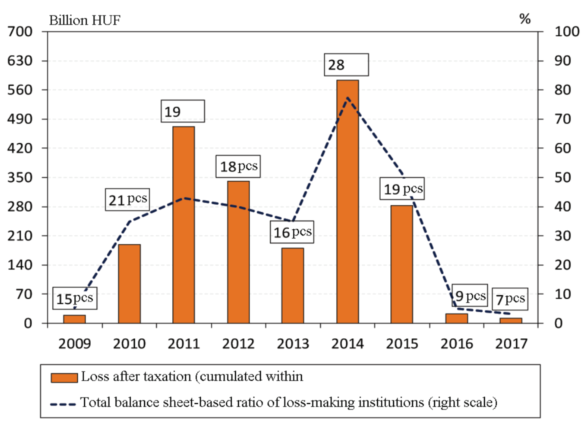
** Annual costs were determined based on data from the first full year following implementation.*
Source: MNB, 2018, e-beszamolo.im.gov.hu

As seen from Table 1, the final repayment of foreign currency loans and, in particular, the interest and the exchange rate spread had the greatest influence on the profitability of banks, which is also reflected in the data of AXA Bank.

Pursuant to the so-called ‘HUF Conversion Act’,[21] foreign currency loans were converted into HUF with effect from 1 February 2015 (at an exchange rate of 256.5 for CHF and 308.97 for EUR). The interest on HUF-denominated loans was tied to the 3-month BUBOR. Additionally, the interest surcharge is identical with the original interest surcharge, but it is at least 2% and not more than 5.5% for housing loans. As a result of lower interest income, HUF conversion led to approximately HUF 100 billion further revenue loss for banks.

However, from 2016 onwards, the lending activity and profitability of banks gained new momentum (see Figure 5). To a non-negligible extent, this was due to the emerging boom on the real estate market and a new wave of residential borrowing, which is now already denominated in HUF.

Figure 5: After-tax losses of banks and branch offices with a negative after-tax profit in Hungary



Source: MNB (2018, Figure 45)

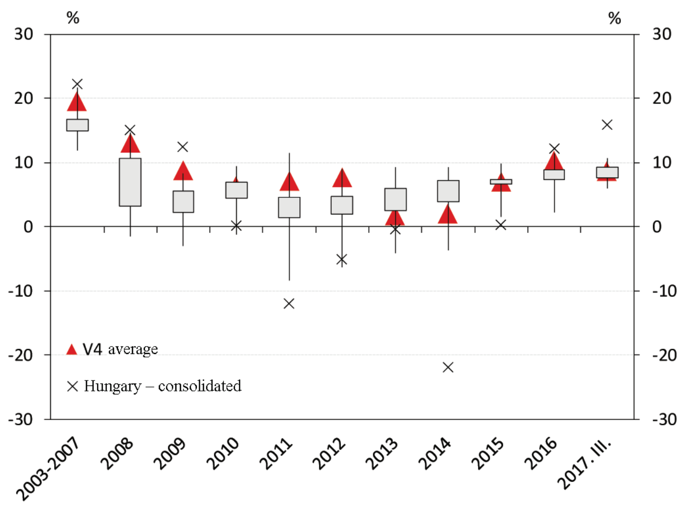
[21] Act LXXVII of 2014

At the beginning of 2016, AXA Bank Europe SA sold its Hungarian business to OTP Bank and left the country. The Hungarian branch office of AXA Bank did not place new loans after 2011, but it had a substantial mortgage portfolio – as a result of the transaction, OTP's mortgage portfolio increased by nearly 20%.

The situation suggests that the French parent bank of AXA was seriously affected by the losses suffered in Hungary and did not have any chance of recovery at the beginning of 2016. *"The share of the Hungarian branch in the balance sheet of AXA Bank Europe SA as of 31 December 2015 amounted to EUR 633 million, while its liabilities represented EUR 662 million. In its annual report, AXA Bank Europe SA mentions the discontinuation of its Hungarian business as part of a strategy that had began a year before. The goal of this step is to focus the activities of the bank solely on its Belgian operations".*[22]

Figure 6 shows that the Hungarian banking system is much more sensitive to cycles than the EU-wide banking system: in periods of booms, it is much more profitable than the European average, but in a recession, it suffers much higher losses. Furthermore, it is easy to be wise after the event, but it seems that the timing of the entry of AXA Bank in the Hungarian market (2009) as well as its exit (2016) could not have been any worse.

Figure 6: After-tax ROE indicator of the EU banking system



Note: The distribution shows the 40–60 and 20–80 percentiles of the EU banking systems.
Source: MNB (2018a, Figure 9)

There are a number of studies dealing with the critical analysis of government measures, and the opinions vary widely.[23] For example, Baksay and Palotai claim that, *"By 2010, as a first step, the government de facto banned residential foreign currency-denominated mortgage loans and took measures that helped to avoid a social disaster. They proclaimed an eviction*

22 www.mno.hu, 2016.

23 BETHLENDI, 2011; KORNAI, 2013, BERLINGER – WALTER, 2013, 2014, 2015; KOLOZSI et al., 2015; BAKSAY – PALOTAI, 2017.

moratorium, reduced the foreign currency exposure of the population through final repayment, and introduced the institution of exchange rate cap".[24]

In my opinion, the social disaster was, unfortunately, only partly avoided. Additionally, this is further reflected in the 2018 Housing Report of an NGO called Habitation for Humanity: *"Currently, about 1.4 million households (one-third of all households) have some kind of loan, and at least 13% of households have been in arrears paying their utility bills for over 60 days, while 750,000 enforcement cases are in progress, amounting to 7% of the annual GDP. Knowing these facts, it becomes clear why there are about a dozen evictions each day, and why the (foreign currency) credit crisis cannot be considered resolved".*[25]

The discounted final repayment of foreign currency loans was extremely harmful, as it helped those who did not need it at extremely high costs, while the support provided to those actually in need was much lower. (It would be worth a separate analysis on why a larger number of people were not admitted to the programme of the National Asset Management Company. As I see it, besides limited state budget resources, complicated administration also played a role in this.) The final repayment destroyed the legal and institutional system by overwriting the existing private contracts: *"In a state governed by the rule of law, the executive and legislative branches cannot force contracting parties, through retroactive legislative acts, to modify their contracts despite their own better judgment. However, this is exactly what the government did again, particularly at the expense of the banking sector".*[26]

Furthermore, this measure has increased moral hazard, as wealthier citizens will probably continue taking greater risks, knowing they will be provided help in an emergency. [27]Additionally, another argument against final repayment is that borrowers have consciously accepted a currency risk in exchange for a lower interest rate; they could have become indebted in HUF as well, and they have long enjoyed the advantages of the difference in interest rates.

I fully agree with the subsequent settlement of interest in both legal and economic terms, as I think the unilaterally variable interest scheme is extremely worrisome from a financial, risk management and consumer protection point of view, and it was not even consistent with the consumer protection regulations in force at the time of conclusion. However, as far as the spread of exchange rate is concerned, I do not think it is technically correct that the middle rate had to be used for settlement – it would have been more appropriate to allow the use of a minimum exchange rate difference, as trading at the MNB's middle rate is not possible.

Furthermore, the conversion into HUF was timed and implemented properly, although the corresponding proposal had been published long before.[28] The systemic risk dropped significantly, and, meanwhile, the banking system emerged from the crisis as well and recommenced in almost every segment. Figure 7 shows the collapse and build-up of foreign currency loans, which reached 10% of GDP at its peak in 2010.

[24] BAKSAY – PALOTAI, 2017. 713.

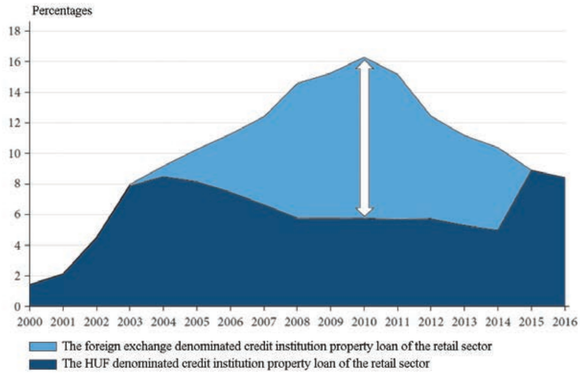
[25] Habitation for Humanity, 2018. 1.

[26] KORNAI, 2013. page 29.

[27] See KORNAI, 2003., 2013. for the soft budget constraint syndrome.

[28] SURÁNYI, 2011.

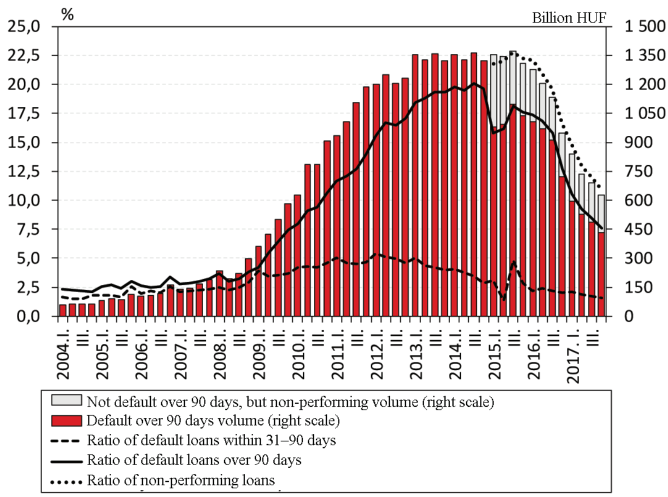
Figure 7: Foreign currency and HUF loans of the household sector as a percentage of GDP



Source: Baksay-Palotai, 2017, Figure 11

A similar share and volume of non-performing loans is shown in Figure 8.

Figure 8: The share of non-performing household loans from credit institutions per contract



Source: MNB (2018a, Figure 35)

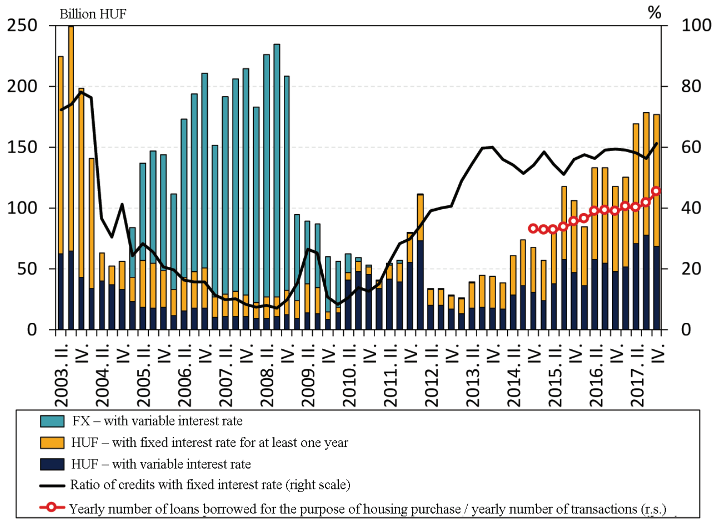
Since 2015, the rate of household loans overdue for more than 90 days has fallen spectacularly (Figure 8, red bars, right scale). This is mainly due to the fact that banks sold a significant share of their non-performing loans to debt management and recovery companies, such that problematic loans disappeared from the balance sheets of banks; however, the social and economic problem did not cease to exist. I am still of the opinion that a real and long-term solution would be the establishment of an income-based collection system that is specifically designed for non-paying debtors, which could be voluntarily joined by debtors and banks (recovery companies).[29]

[29] For details on our suggestion, see: BERLINGER – WALTER, 2013., 2014., 2015.

3. Variable interest rates

Over the past eight years, a new wave of residential housing loans has emerged, although at a more modest level, where the role of foreign currency loans has been taken over by HUF loans (see Figure 9).

Figure 9: Volume of new housing loan contracts by interest and denomination



Source: MNB (2018b, Figure 33)

However, HUF loans vary widely based on how long the interest rates are fixed. Suppose you currently want to take out a housing loan of HUF 20 million for 20 years. Table 2 shows the lowest annual percentage rate (APR) that can be reached with different interest periods using the bankracio.hu search engine.

Table 2: Mortgage loan offers (20 years, HUF 20 million, 13/Oct/2018)

Interest period (year)	Lowest APR	Monthly instalment (HUF)	Credit interest	Government bond reference yield	Estimated interest surcharge
1	2.64%	107,013	2.57%	0.38%	2.19%
3	3.89%	118,994	3.79%	1.89%	1.9%
5	3.55%	115,814	3.45%	3.33%	0.12%
10	4.06%	121,317	3.98%	3.92%	0.06%
20	5.26%	132,988	5.09%	4.39%	0.7%

Source: www.bankracio.hu, www.akk.hu

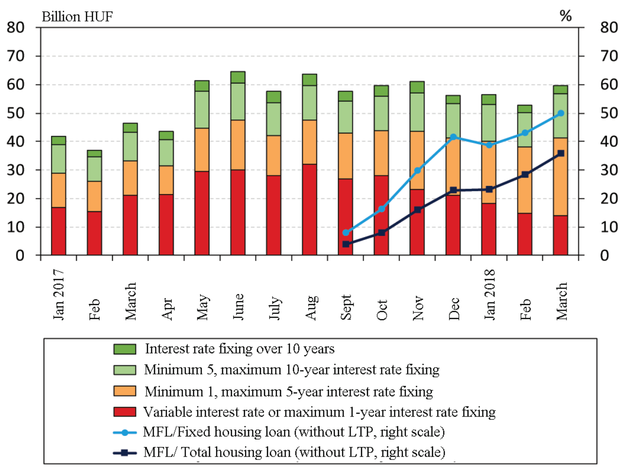
We can see from Table 2 that the APR is highly dependent on the interest period chosen by the borrower, i.e., how long he/she fixes the interest rate on the loan. The APR difference between interest rates fixed for 1 year (2.64%) and 20 years (5.26%) is currently 2.62%, which results in a monthly difference of 132,988–107,013 = 25,975 in the amount of instalment. Furthermore, loan interest rates are somewhat lower than the APR, as the latter includes the impact of various one-off charges as well. Additionally, government bond reference yields show the yields (internal rates of return) of 1-, 3-, 5-, 10- and 15-year government bonds, which can be considered a risk-free return for the relevant period. The estimated interest surcharge is the difference between the loan interest rate and the reference yields of government bonds (the contracts do not necessarily include exactly the same interest surcharges, as different reference yields may be used, but the deviation cannot be too high). It is conspicuous that the interest surcharge is the highest for the 1- and 3-year interest periods, suggesting that banks try to motivate clients to use longer interest fixation periods.

Note that the same table contains somewhat different data for the summer of 2017 – the APR difference was higher (3.52%), the difference between instalments was also higher (HUF 36,000) and the interest surcharges were distributed much more evenly, close to 2%. [30]

The shift is largely due to the fact that MNB was aware of the risk associated with loans with a variable interest rate and used several different instruments to motivate clients to fix loan interest rates for a longer period of time. The most important of these instruments are the increasingly strict debt brake rules, cheap refinancing options provided to banks for longer-term loans and qualified consumer-friendly housing loans (MFL). The MFL initiative was launched by the MNB, and banks could voluntarily join, agreeing to offer their clients more favourable and safer housing loan schemes (fast administration, interest rates fixed for at least 5 years, cheap prepayment, maximised charges, etc.). Thus, MFL was, in its spirit, extremely similar to the Code of Conduct, but, interestingly, it was perceived much more positively by banks and clients in every respect.

Figure 10 shows that within new loans, the share of loans with interest rates fixed for 1 to 5 years has increased over the past one or two years, but, most probably, there are still many loans within the total volume with an interest period of less than 1 year.

Figure 10: Distribution of disbursed housing loans by interest rate fixation period and share of MFL products



Source: MNB (2018a, Figure 25)

This means borrowers are faced with the dilemma of whether to take a higher risk with a lower interest cost or a lower risk with a higher interest cost. In the current environment of low interest rates, a short interest period is risky, as interest rates are almost at a historic low all around the world;

30 BERLINGER, 2017.

it must also be noted that the period of low interest rates has never been so long. In the future, if interest rates rise, instalments will also be increased almost immediately if the interest period is short. I have concluded in another study that in case of a 1 percentage point increase in interest, the percentage change of instalments is at least the average time of cash flow fixed with current interest rates (the impact is slightly higher due to the curvature).[31] This means that if current low interest rates increase by 1 percentage point, the monthly instalment for a 20-year loan will increase by almost 10%. Additionally, I have also used a scenario analysis to demonstrate that if risk-free interest rates rise to a realistic level of 5% in the near future (2% real interest rate + 3% inflation), the monthly instalment of a 20-year loan will increase by approximately 50%. As seen in the case of foreign currency loans, an average increase of 50% to 60% in instalments led to a default ratio of more than 22%. This can happen again if default rates continue to be so closely related to the instalment/income ratio as before.[32]

Table 3 compares the cumulative volume and riskiness of variable-rate HUF and floating-rate foreign currency loans.

Table 3: Comparison of variable-rate HUF and foreign currency mortgage loans

	New mortgage loans for housing purposes 2013–2017	Total volume of foreign currency mortgage loans End of 2008
Value of contracts	~1,872 billion HUF*	~2,300 billion HUF
Includes interest periods shorter than 1 year	~ 750 billion HUF	
Number of contracts	~ 234,000**	~500,000
Share within household loans (in value)	46%***	68%
APR difference	2–3%	5–6%
Increase in instalment	49%****	~50–60%
Share of non-performing loans	?	~ 22%

** Adding up the volume of new loans in 2013–2017 (MNB, 2018b, Figure 33)*
*** Estimated value assuming an average credit value of HUF 8 million (MNB, 2018a, Table 6)*
**** Calculated based on MNB (2018a, Figure 24) for the years 2013–2017*
***** Calculated with scenario analysis with 2% real interest rate and 3% inflation, 20 year term and annual re-pricing*
Source: own editing

The volume of foreign currency mortgage loans at the end of 2008 was the result of intensive lending for about 4 to 5 years. For the sake of comparability, in Table 3, I have aggregated data for the latest wave of housing mortgage loans for the past 5 years – from 2013 to 2017. The value of contracts (1,872 billion HUF) was close to, but did not reach, the value of foreign currency loans in 2008 (2,300 billion HUF), and, of course. it was also less in real value, especially when compared to income. If, however, data for 2018 were also added, we would probably end up with a figure of the same order of magnitude. Moreover, no public data is available on the distribution of interest periods for the total volume of loans; hence, I can only estimate that the share of loans with an aggressively variable rate (interest periods shorter than 1 year) may be approximately 40%, i.e., they amount to about HUF 750 billion.

The main message of Table 3 is that, at first glance, HUF-denominated variable-rate mortgage loans do not seem to be as risky as foreign currency loans, but a sudden increase in interest rates can easily result in a 50% rise in instalments, which can again lead to a default rate of up to 22%. All this depends on

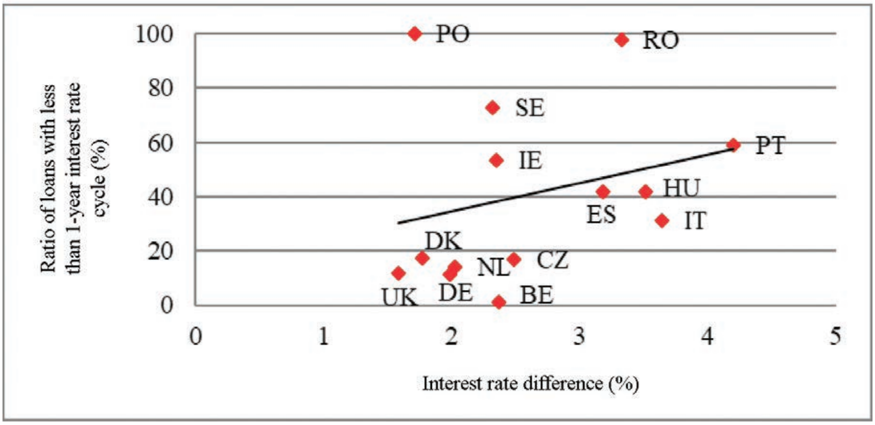
[31] BERLINGER, 2017.

[32] BALÁS – BANAI – HOSSZÚ, 2015.

how quickly and to what extent the interest rates rise, what is the maturity structure of the loan portfolio, what is the rate of increase in instalments that is still tolerable for borrowers with their current income and, of course, how the general economic situation and the value of real estate collaterals develops.

The share of loans with a variable interest rate is not exceptionally high in Hungary in a European comparison (see Figure 11).

Figure 11: The share of variable-rate loans in the EU depending on the difference in interest rates



Source: EMF (2017/Q2), Bloomberg

For example, the interest period of the total volume (100%) of residential mortgage loans in Poland is shorter than one year, and the situation is similar in Romania and Sweden as well. The high share of variable-rate loans in these countries may become a critical problem in case of a significant increase in interest rates, which may affect the entire European banking system. Figure 11 confirms that a higher interest rate differential shifts, lending towards shorter interest periods.

Analysing a sample of sixty thousand people, *Dancsik* found that an exchange rate loss suffered earlier from foreign currency loans increases the likelihood of a client fixing the interest rate of a new HUF loan for at least 5 years.[33] This means that clients who have burnt themselves with foreign currency loans are now more cautious with HUF loans with a variable interest rate. In addition, even higher incomes and higher loan/collateral ratios increase the likelihood of interest rate fixing. However, if the term is longer, the client has had a mortgage loan earlier, the services of a credit intermediary are used or there is a large difference in interest rates (which is consistent with the positive relationship shown in Figure 11), then it is more likely that a short interest period will be chosen.

It is generally taught during financial awareness campaigns that attention should be paid to APR, and it should be minimised. Additionally, offers are automatically listed in ascending order of APR by Internet search engines. However, if someone blindly follows this advice, paradoxically, due to the method used for the calculation of APR, they may choose potentially riskier (e.g., CHF-based or very quickly re-priced variable-rate) schemes, often without being aware of this fact. To increase risk awareness, I have suggested changing the calculation method of APR.[34]

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[33] DANCSIK, 2017.

[34] BERLINGER, 2017.

4. Conclusions

In this study, I have presented the history of residential foreign currency loans and HUF mortgage loans in recent years from a specific perspective – changes in regulations for loan interest rates. The focus was on taming variable, and then floating interest rates, where we have undoubtedly come a long way and achieved significant results. However, development has not been easy for either borrowers, banks or the supervisory authorities, and we still cannot be sure that the residential mortgage loan portfolio is developing healthily in every respect. We particularly cannot be certain regarding what will happen to the victims of earlier credit crises (OTP residential loans and foreign currency loans), especially to non-performing debtors who have been in a hopeless situation for a long time.

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LEGISLATIVE STEPS IN HUNGARY TO ADDRESS ISSUES CONNECTED WITH FOREIGN CURRENCY-BASED CONSUMER LOANS

1. The Economic and Social Background of Foreign Currency Lending

1. 1. The Role of Real Estate Property in Hungarian Society

Over the last hundred and fifty years, Hungarian society witnessed the radical transformation of ownership structures on three occasions. One of the main achievements of the Revolution and Freedom Fight of 1848-1849 was the liquidation of feudal ownership. After 1945 nationalisation affected society as a whole with central planning introduced in the economy. As a result, private ownership had dropped to a minimal level and was virtually restricted to housing property. In the wake of the political changeover of 1989-1990 an opposite process unfolded: state property was dismantled, privatisation and restitution began. Private property expanded rapidly and the number of privately-owned businesses (business associations) increased from 45.770 in 1990 to over 280.000 in 1997.[1] These developments have determined both the attitude of the Hungarian population to property and the development of areas of law that are closely associated with economy, like civil law.[2]

Due to historical upheavals, real estate ownership has gained special significance in Hungarian society. As a vestige of archaic rural society, this includes the ownership of both arable land and the house. Real estate ownership which should be preserved and extended is also characteristic of the bourgeois mindset.[3]

One of the features of residential property is that it either requires total renovation by each generation or it should be replaced by an entirely new home. In view of the number of inhabitants and the size of families, around 40.000 new homes should be constructed in Hungary each year. This target was met by the first Orbán government (1998-2002) for the first time since the 1980s. The subsidized forint-based home loan scheme of the first Orbán government was the first successful attempt that besides increasing the number of housing constructions, also encourage newlyweds to move into modern homes of their own.[4] Consequently, the number of residential constructions increased steadily from 1999.[5]

1 At the same time the number of state corporations decreased drastically: whereas in 1990 there were 1859 such companies, their number dropped to 3 by 1997. The number of businesses owned by the state, however, was much higher than that. The increased number of business associations implied more insolvency procedures. See.: HARMATHY, Attila: *Das Recht der Mobiliarsicherheiten – Kontinuität und Entwicklung in Ungarn.* In: KREUZER, Karl F. (Hrsg.): Mobiliarsicherheiten – Vielfalt oder Einheit?, Nomos, Baden-Baden, 1999. p. 78-83.

2 On the impact of the last 150 years on civil law see: HARMATHY, Attila: *Jogpolitika – polgári jog.* Magyar Jog, 12/2010. p. 705-719.

3 KOVÁCS Levente: *A devizahitelek háttere.* Hitelintézeti Szemle, 3/2013. p. 183., See also: KATZENBACH Zoltán – OSVÁTH Piroska: *Lakhatás és befektetés – egy új lakásfinanszírozási modell.* Hitelintézeti Szemle, 4/2012. p. 289-297.

4 KOVÁCS: i.m. 183.

5 In 1999 19.287 new apartments were built; in 2000 the number was 21.583 and in 2001 it was 28.054 and in 2002 31.511. Source: Central Statistical Office (KSH)

1. 2. Switching to Foreign Currency-based Residential Mortgage Loans

Following the general elections of 2002, the new government discontinued the interest-rate subsidization of mortgages denominated in forints for budgetary reasons. People, however, continued to yearn for owning a home. Forint-based residential lending became unsustainable in the absence of subsidies due to the fact that while the base-rate of the forint ranged between 8-12%, the market interest rate was 14-18%.[6]

Extremely high forint interest rates triggered the (seemingly good) idea of switching residential mortgage landing to foreign currencies as these were available at lower interest rates. Inflation as well as the high base-rate directed households towards foreign currency loans due to significant interest rate differentials.[7] This was the time when loans denominated in foreign currency, in particular Swiss francs, which were offered at a low interest rate, appeared on the Hungarian market. These foreign currency-based housing loans were associated with a reduced payment obligation owing to lower interest rates. The repayment curve of the foreign currency-based loans was also more attractive as the debt service started from a low level, therefore initial payment burdens were lower than in the case of forint-based loans.

Nevertheless, this lower interest burden was offset by the ever-fluctuating exchange rate of the principal debt. At first the issue of the exchange rate risk was completely set aside. The stable interest rate of foreign currencies which was much lower than that of the forint was taken into consideration instead. A classic bubble phenomenon could be observed on the market. Debtors and creditors both appeared to nearly totally ignore risks in the hope of huge profits. The majority of borrowing households only took the monthly payment instalment into account when making the decision. As for the lending banks, they made their assessment and took decisions on the basis of real estate collateral rather than by examining the future life situation and the payment capacity of prospective debtors.[8] With hindsight, it can also be established that banks failed to act in a in good faith when they accepted properties that had no chance to be sold on the market (for instance residential real estate properties taken over by the National Asset Management Program) as collateral.[9]

The proliferation of foreign currency-based loans can also be attributed to the fact that judging from political declarations, in 2003 the financial sector could reasonably expect the introduction of the euro as legal tender in Hungary within a few years. It seemed to be a logical choice to offer long-term loans spanning several decades in euros or Swiss francs anchored to it rather than in the constantly appreciating forint with its high interest rates. This solution enabled wider segments of the Hungarian population to upgrade their home or acquire a new home despite the relatively low level of wages in the country.[10]

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6 KOVÁCS: i.m. p. 184. During this period the base rate of the central bank and the inflation rate were both rather high: In 2002 5,2 %, in 2003 4,7 %, in 2004 6,8 %. Source: KSH. Rising inflation was mostly linked to budgetary adjustments.

7 NYESTE, Orsolya – ÁROKSZÁLLÁSI, Zoltán: *Devizahitelezés Magyarországon – régiós makrogazdasági, fiskális és monetáris politikai megközelítésben.* In: KOVÁCS, Levente (szerk.): Negyed százados a magyar bankrendszer. Magyar Bankszövetség. Budapest, 2012. pp. 149., 153.

8 NYESTE – ÁROKSZÁLLÁSI: i.m. p. 150.

9 The National Asset Management Program was launched pursuant to Act CLXX of 2011 on the housing provisions of natural persons incapable of meeting their payment obligations under their loan

10 KOVÁCS: i.m. p. 185.

As a consequence, housing constructions continued to pick up, then peaked in 2004.[11] During this year over 43,000 new homes were built in Hungary. Subsequently the number of constructions showed a slight downturn before and stagnation until 2008, then fell rapidly.[12]

1. 3. Impacts of the 2008 Crisis

In the wake of the 2008 financial and economic crisis, whereas the Hungarian forint depreciated substantially, the euro and even to a greater degree, the Swiss franc appreciated significantly. In the very year of 2008, 90% of new residential loans were denominated in foreign currency.

The first signs of the storm, however, had emerged as early as in 2006. This is when the interest rate of the Swiss francs and of the euros moved apart due to the fact that the European Central Bank started to raise interest rates in 2006. As a result, between 2006 and 2008 the average interest rate of loans denominated in euros first exceeded 10 %, then after a slight decrease stabilized around 10 % from 2009 onward. In the meantime, the average interest rate of Swiss franc-based mortgage loans was 5-6% and exceeded 6% only from 2009 onward.[13]

Since the Hungarian financial supervisory authority failed to take measures, foreign currency lending became particularly widespread between 2006 and 2009. The foreign currency loan portfolio of households grew from 2,000 billion forints (approximately EUR 6,2 billion) at the end of 2006[14] to 6.000 billion forints (approximately EUR 19 billion) by early 2009. It is perplexing that the foreign currency loan portfolio of the Hungarian population should have increased with a further amount of 1.000 billion forints (approximately EUR 3 billion) even after the onset of the financial crisis.[15]

Foreign currency lending was initially dominated by housing loans, however, free-to-use mortgage loans became increasingly popular later on and were used by households for consumption purposes.

The Hungarian financial supervisory authority first reacted in substance to the risks associated with foreign currency-based lending immediately before the outbreak of the crisis, on 15 February 2008. The Chairman of the National Bank of Hungary (MNB) and the Chairman of the Supervisory Council of the Hungarian Financial Supervisory Authority (PSZÁF)[16] issued a joint recommendation on the systemic risks involved in foreign currency lending. Apart from the fact that it was several years overdue, the recommendation identified an interestingly increased risk with regard to Japanese

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11 In 2003 35.543 new homes were built. Source: KSH

12 In 2005 41.084, in 2006 33.864, in 2007 36.159, and in 2008 36.755 homes were built. The number of housing constructions subsequently dropped sharply: in 2009 31.994, in 2010 20.823, in 2011 12.655, in 2012 10.560 and in 2013 only 7.293 new homes were constructed. Source: KSH

13 The interest rate of free-to-use Swiss franc-based loans was higher by around one percent. For more details see: PITZ, Mónika: *A svájcifrank-alapú jelzáloghitelek kamatait alakító tényezők*. Hitelintézeti Szemle, 2012. augusztus, Különszám, pp. 62-69.

14 In the present study the 320 HUF/EUR exchange rate was used

15 In addition, foreign currency loans were granted to the corporate sector as well, the expansion of which was the most spectacular in 2007 (cca. HUF 800 billion/EUR 2,5 billion) and in 2008 (cca. HUF 900 billion/ EUR 2.8 Billion). See: NYESTE – ÁROKSZÁLLÁSI: i.m. p. 150.

16 The MNB and the PSZÁF used to be separate organisations at the time.

yen-based lending.[17] Since then it has become apparent that debtors of yen-based loans suffered the least in the crisis owing to the decrease of the interest rate of the yen as well as its weakening.

The reaction was delayed. In fact, by this date the phenomenon that was to distress Hungarian debtors was in full swing: namely that not only the forint, but the euro also depreciated considerably against the Swiss franc. During the crisis the Swiss franc became a reserve currency (safe haven currency) and as a result, strengthened by around 25 % against the euro. Meanwhile, the forint weakened by around 10 % against the euro. As an overall outcome, while in early 2008 one Swiss franc was worth ca. 150 forints, in 2010 it stood at 200 forints, and in 2012 it reached 250 forints. The depreciation of the forint against the euro was less marked, but still impressive: whereas at the beginning of 2008 one euro was worth around 250 forints, it stood at 280 in 2010 and at 300 in 2012.

The rapidly deteriorating forint, especially against the Swiss franc, affected the situation of indebted households drastically. As far as banks are concerned, the quality of their mortgage loan portfolio declined, as the share of non-performing loans within the portfolio rose consistently.[18]

In response to the 2008 crisis, Hungary's country risk rating (the so-called CDS spread) increased considerably.[19] While in September 2008 the spread of the five-year Hungarian foreign currency bond yields fluctuated around 100 basis points, two months later it reached 700 basis points. Simultaneously, the refinancing costs of the Hungarian banks increased, too. However, the further increase of refinancing costs was halted by the fact that both the European Central Bank and the Swiss central bank introduced interest rate cuts.[20] As the financial authority failed to take measures and no limits had been set by national legislation, Hungarian banks, that are regularly abusing their statutory right to amend contracts unilaterally, embarked upon interest raising. Acting contrary to the original purpose of their unilateral right to modify the contracts, the Hungarian banks started to use this tool to augment their profit.

1. 4. Other Reasons for the Prevalence of Foreign Currency Lending

The wide-spread use of foreign currency lending stemmed from other factors as well, including competition between the banks based increasingly on risk, considerable information asymmetry between creditors and debtors, the instability of the financial

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17 The Austrian financial authority issued a Communication as early as on 30 June 2006 to highlight the risks associated with foreign currency-based loans. One of its key statements is that all foreign-currency-based loans are ultimately forein currency speculation transactions. See: https://www.fma.gv.at/de/ueber-die-fma/presse/pressemitteilungen/pressemitteilungen-detail/article/fma-und-oenb-praesentieren-einen-informationsfolder-zu-den-risiken-von-fremdwaehrungskrediten.html Later, in October 2008 the Austrian financial authority practically prohibited the granting of new foreign currency-based loans. In 2008 yet 270.000 Austrian households had a foreign currency (in particular Swiss franc)-based loan agreement, this number fell by 45% by 2018, i.e. to 150.000 due to the prohibition.

18 NYESTE – ÁROKSZÁLLÁSI: i.m. p. 150.

19 The value that shows how risky it is for a foreign bank to lend in a given country.

20 As a result, LIBOR rate decreased to 0 %. In the meantime, the CHF LIBOR turned negative. On 27 February 2015 its three month LIBOR was -0,73 %. This trend affected the euro as well: the one-week EUR LIBOR stood at -0,06 % on the same day. Hence it was necessary for the Hungarian legislature to take action and to clearly state in connection with the negative interest rate that in accordance with Hungarian civil law negative interest rates cannot be charged in the case of loan agreements. See: Sections 2(5) and Section 3 of Act II of 2015 amending Act on the Consumer Loan Agreements of Financial Institutions and other private law related acts.

intermediaries, financial illiteracy as well as failure to introduce lending rates pegged to the reference interest rate. These issues were addressed in the Report of the Parliamentary Committee for Constitutional, Justice and Procedural Matters of February 2012.[21]

In economics literature it is held that the spread of foreign currency lending in a catching-up, small, open, liberalized and under-capitalized economy is a natural phenomenon associated with an open foreign currency position. In the case of Hungary, however, open foreign currency positions appeared on the balance sheet of the retail sector with higher amounts than in other countries of the region, which led to systemic problems when the crisis broke out in 2008. The indebtedness of the sector in foreign currencies, that subsequently turned out to be unsustainable, should be seen as a symptom that reflected mostly the so-called crowding out effect of the unruly fiscal policy, the conflicts between the monetary and the fiscal policies as well as the fundamental structural issues of the Hungarian economy.[22]

1. 5. Belated Legislative Measures

Due to its size and the associated risks, by the early 2010s the retail foreign exchange loan portfolio had become an obstacle to economic growth. The following data serve to illustrate the burden weighing on society as a whole: at the end of June 2014 the retail foreign exchange loan portfolio was still above 4,147 billion forints (EUR 13 billion), of which 3,607 billion forints (EUR 11 billion) represented mortgage loans. In the same period the forint denominated retail loan portfolio amounted to 3.792 billion forints (EUR 12 billion) (of which 2.122 billion forints – i.e. EUR 6,6 billion constituted mortgage loans). In aggregate there were approximately 872.000 existing retail foreign currency loan contracts at the end of the first half of 2014.[23]

The legislature was therefore constrained to take steps. As a first major result, foreign currency retail lending was virtually banned in 2010. This was followed by further legislative measures that are of outstanding relevance both economically and legally. In 2014 retail mortgage loans were converted into forints then in 2015 the same was done to personal loans and car loans. However, before going into the details of the provisions, it is necessary to provide an overview of the legal nature of foreign currency-based loans as special banking products.

2. The Legal Nature of Foreign Currency Based Loan Contracts

2. 1. Foreign Currency Loan and Foreign Currency-based Loan

When examining the legal characteristics of foreign currency-based loan contracts, one should start with the term itself. As pointed out in the recital of Uniformity Decision 6/2013 PJE of the Hungarian Supreme Court, the Kúria, the notion of foreign currency loan was not defined in any legal regulation when foreign currency lending became a common practice. A definition was provided only later on in Section 200/A (1) of Act CXII of 1996 on

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21 http://www.parlament.hu/irom39/05881/05881.pdf

22 NYESTE – ÁROKSZÁLLÁSI: i.m. p. 164.

23 Out of these the number of debtors with debts more than 90 days overdue was 195.000, affecting a FX loan portfolio of 973 billion forints (EUR 3 billion). Thus, the share of bad loans exceeded 22-23 %. Source: MNB.

Credit Institutions and Financial Enterprises (former on Credit Institutions Act), which was effective from 27 September 2010. In accordance with this Act, foreign currency credit and loan agreements as well as financial leasing agreements are classified as foreign currency-based if they are denominated or provided in a foreign currency and repaid in forints.

Foreign currency-based loans come under the wider notion of foreign currency loans. Foreign currency loans are defined as loans where the currency of the debt claim is not the Hungarian forint. In the absence of a statutory prohibition, the parties to a contract of pecuniary interest are essentiallyfree to define the currency of the claim (principle of free settlement). According to the above a foreign currency-based loan is also a foreign currency loan since the debt is determined in a foreign currency. What is specific to it, however, is that the creditor should disburse the loan in forints and the debtor should repay it in forints, that is both the creditor and the debtor are obliged to pay the obligation in forints.

In this regard, Decision 6/2013 PJE of the Kúria stresses that parties are not prevented from agreeing that both of them shall be obliged to fulfil their obligations in the currency in which the debt was denominated (effectivity clause). In this case both the disbursement and the repayment are honoured in the currency in which the debt was denominated (in this case in foreign currency). Hence, there are two types of foreign currency loans: (genuine) foreign currency loans with an effectivity clause and foreign currency-based loans without an effectivity clause. In the absence of an agreement between the parties, foreign currency-based loans are the general rule, genuine foreign currency loans being an exception requiring the explicit agreement between the parties.

Hungarian civil law differentiates between credit and loan contracts.[24] Such differentiation, however, is not relevant for the purposes of the present study. Irrespective of whether the laws or the parties have called their contractual relationship a credit contract or a loan contract, the point is that the debtor acquires the right to the temporal use of the foreign currency according to a scheme under which the currency of the denomination and of the payment differed. This means, as established by Decision 6/2013 PJE of the Kúria, that the parties define the pecuniary obligation in such a way that at the due date the debtor will pay (discharge) an amount in forints that is equivalent to the pecuniary debt defined in the contract in a foreign currency (typically Swiss francs, euros, Japanese yens). When entering into a foreign currency-based loan contract, the borrower intends to access as well as to repay the loan in forints, while his interest payment obligation should be much lower than that of forint loans applied at the time of the conclusion of the contract. This requirement was fulfilled by foreign currency-based loan schemes the legal basis of which was established by Section 231 of Act IV of 1959 on the Civil Code (hereinafter 'Civil Code of 1959').

2. 2. On the Invalidity of the Contractual Arrangement

As far as invalidity is concerned, distinction should be made between individual consumer loan contracts on the one hand and foreign-currency-based loan contracts as a contractual arrangement on the other.

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24 While credit contracts are governed by Section 6:382 of Act V of 2013 on the Civil Code (hereinafter Civil Code), loan contracts are governed by Sections 6:383-389 of the Civil Code. A key difference is that under Hungarian civil law, actual transfer of money only occurs in the case of loan agreements.

With respect to the latter, Decision 6/2013 PJE of the Kúria held that the arrangement itself was nor in conflict with any statutory regulation, and was neither manifestly immoral. The main argument of the uniformity decision in this respect is that at the time of the enactment of foreign currency-based contracts these contracts were not condemned by the public.

Simply due to the contractual arrangement, foreign currency-based loan agreements cannot be considered as usurious or false either, nor are they intended for the purposes of providing impossible services.

As an overall assessment, the Kúria stated that the unforeseeable one-way shift of contractual burdens after the conclusion of the contract cannot be evaluated from the viewpoint of invalidity. Changes, however, might occur subsequently during a long-term lending relationship that will upset the economic and risk balance of the contract and will lead to serious disproportions. Although this does not affect or interfere with the validity of the contract, it might necessitate subsequent intervention in the contracts unless the parties are able to remedy these disproportions mutually through contract modification. According to the Kúria, however, the latter qualifies as contract amendment through legislation.

2. 3. The Issue of Unfairness

The contractual arrangement of foreign currency-based consumer loan agreements was not regarded as invalid by Hungarian judicial practice. A reason for invalidity, however, may exist in the case of individual loan agreements. Such reason, however, should be established by a court during its proceedings or in exceptional cases, by legislation. Unfair contractual terms are the most significant reason for the invalidity of individual consumer contracts.

Under Hungarian civil law this is the only ground for invalidity with a European legal background. In fact, a separate piece of EU legislation, Directive 93/13/EEC lays down the provisions on unfair general terms and conditions in consumer contracts as well as of unfair contractual terms not negotiated individually. The relevant provisions of the Civil Code of 1959 transposed the provisions of Directive 93/13/EEC on unfair terms applied in consumer contracts. As these rules are set out in a Directive, ultimately the European Court of Justice (hereinafter ECJ) is entitled to interpret the relevant provisions. Therefore the Hungarian legislature as well as those applying the law must take both Hungarian judicial practice and the case law of the ECJ into account.

2. 4. The Requirement of Transparency

Article 4(2) of Directive 93/13/EEC stipulates that the assessment of the unfair nature of terms does not relate either to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration against the services or goods supplied in exchange in so far as these terms are plain and intelligible. As an exception to the principal prohibition, the unfairness of the terms can also be examined if they are not plain and intelligible. In fact, the requirement of transparency is gaining ground in both the EU law and the private law of the member states.[25]

[25] See Max, LEITNER: Transparenzgebot. Wien, Manzsche Verlag- und Universitätsbuchhandlung, 2005. 160. p.

2.4.1. The Requirement of Transparency in the Case-Law of the European Court of Justice

In 2013 the Kúria addressed the European Court of Justice with a request for preliminary ruling in order to clarify among others, whether not individually negotiated contractual terms incorporated into foreign-currency based loan agreements, pursuant to which currency exchange rates are applied, may be interpreted as falling within 'the main subject matter of the contract' (C-26/13). In this context the Kúria and the European Court of Justice examined mainly the unfairness of contractual terms with regard to various exchange rates applied by banks (i.e. exchange rate margins).

In its judgement in case C-26/13 of 30 April 2014 the ECJ stated in particular that the requirement of transparency of contractual terms laid down by Directive 93/13/EEC cannot therefore be reduced merely to their being formally and grammatically intelligible. The ECJ stated that as the system of protection introduced by Directive 93/13/EEC was based on the idea that the consumer is in a position of weakness *vis-à-vis* the seller or supplier, in particular as regards his level of knowledge, the requirement of transparency must be understood in a broad sense.

The Court ruled that Article 4 (2) of Directive 93/13/EEC shall not only be interpreted to mean that the term in question should be grammatically intelligible to the consumer. Compliance with the requirement of transparency also necessitates determining whether the contract sets out transparently the reason for and the particularities of the mechanism, for converting the foreign currency as well as the relationship between that mechanism and the mechanism laid down by other terms relating to the advance of the loan, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it.

The statements issued in Case C-26/13 have been confirmed and developed in further judgements of the EJC. In its judgement in Joined Cases C-154/15, C-307/15 and C-308/15 of 21 December 2016 the European Court of Justice ruled that the requirement of transparency laid down in Article 4 (2) of Directive 93/13/EEC, must be construed as involving not only formal compliance, that is the clear and intelligible nature of its formulation, but also the respect of transparency in practice. Transparency in practice means that the consumer should be provided with sufficient information on the legal and economic aspects of his contractual commitment.

The EJC reaffirmed that it is of fundamental importance for a consumer to have information on the contractual conditions and the consequences of entering into that contract before the conclusion of that contract. Therefore on the basis of the case law of the ECJ it can be established that the assessment of the unfair nature of a contractual clause relating to the definition of the main subject-matter of a contract falls within the scope of Directive 93/13/EEC where the consumer did not have the necessary information on the contractual conditions and the consequences of entering into that contract before the conclusion of that contract.

In its judgement in Case C-186/16 the ECJ added to the above that financial institutions must provide borrowers with sufficient information to enable them to take prudent and well-informed decisions. Such information must include the impact of a severe depreciation of the legal tender of the Member State in which a borrower is domiciled, and of an increase of the foreign interest rate, on instalments. An average consumer should be aware that in the value of the foreign currency loan, both a rise or a fall may occur of the foreign currency in which the loan was taken out, and he should also be able to assess the potentially significant economic consequences of such a term with regard to his financial obligations.

In its Judgment in Case C-51/17, the EJC underlined that the requirement stemming from Article 4 (2) of Directive 93/13/EEC means that a term relating to the foreign exchange risk must not only be understood by the consumer at the formal and grammatical level, but also in terms of its actual effects. This means that the average consumer, who is reasonably well informed and reasonably observant and circumspect, should be aware of the possibility of a depreciation of the national currency in relation to the foreign currency in which the loan was denominated. The EJC stressed again that an average consumer should be able to assess the potentially significant economic consequences of such a term with regard to his financial obligations.

2.4.2. Evaluation of the Case-Law of the European Court of Justice

As for the assessment of the requirement of transparency, it should first be noted that the case law of the European Court of Justice is evolving and expanding continuously. On the other hand, when interpreting the transparency requirement of Directive 93/13/EEC it is clearly visible that the issues in which the breach of the obligation to inform the consumer prior to concluding the contract overlap with those of the unfair, not individually negotiated contractual terms. At the EU level this does not cause any problems, since it is limited to the unfairness of not individually negotiated contractual terms. In this regard, Article 6 (1) of Directive 93/13/EEC stipulates that Member States should lay down that unfair terms used in a contract should not be binding on the consumer. If the contract is capable of continuing in existence without the unfair terms, it shall continue to bind the parties upon unchanged terms.

Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.

Hungarian civil law satisfies this requirement by stipulating that unfair contractual clauses shall be null and void. Such grounds of invalidity typically gives rise to partial invalidity, to which reference is made by *Lajos Vékás: „Nullity ousts the unfair clause, preventing it from producing legal effect, nevertheless the other parts of the contract shall bind the parties”*[26] This follows from Section 6:103 (3) of the Civil Code as well, which provides for the nullity of the unfair clause, rather than that of the entire contract. Pursuant to Section 6:114 (2) of the Civil Code, in the event of limited invalidity of a consumer contract, the entire contract shall fail only if the contract cannot be performed without the invalid part.[27]

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[26] VÉKÁS, Lajos: *Szerződési jog. Általános rész*. Budapest, Eötvös Kiadó, 2016. p. 135.

[27] This provision was used in a number of cases by the Hungarian courts to rule on the total invalidity of consumer loan agreements due to the unfairness of provisions in transferring the exchange rate risk to debtors. In some cases, however, the court established only the partial invalidity of the contract. In a particular case, the Regional Court of Debrecen ruled that what is unfair is the unlimited extent to which the exchange rate is transferred to the debtor. On the basis of the oral information he had received, the debtor might have thought that the exchange rate risk affected him only in a limited manner, amounting in the worst case to his instalment increasing to HUF 47.000. The fact that the exchange rate risk was entirely transferred to the consumer resulted in the partial invalidity of the part exceeding the 223 HUF/CHF exchange rate. Consequently, the relevant contractual terms are not unfair in their entirety, unfairness being limited to specific, well-defined parts. In fact if on the basis of the information received at the time of concluding the contract the consumer could have assumed that the exchange-rate risk exposure had an upper limit, risk-taking exceeding such ceiling is invalid. (ÍH 2017. 56)

At the level of Member States' civil law, however, mixing the obligation to inform the consumer prior to concluding the contract with the invalidity of any unfair clause of the consumer contract has led to further problems. In Hungarian civil law, under Section 6:62(1) of the Civil Code the duty to communicate information prior to concluding the contract is included under the general provisions governing contracts. Pursuant to this section, the parties are required to cooperate during preliminary negotiations, at the time of the conclusion and termination, and during the life of the contract, and are bound to communicate information to each other on circumstances relevant to the contract. In accordance with Subsection (3) if the contract is concluded, the party who breaches the obligations referred to in Subsection (1) shall be subject to liability for damages caused by non-performance of an obligation to the other party. In addition, Subsection (5) stipulates that if the contract is not concluded, the party who breaches the obligation referred to in Subsection (1) shall be subject to liability for damages in accordance with the general provisions of non-contractual liability.

The above shows that for any breach of the duty to provide information prior to concluding the contract, Hungarian law imposes a payment of compensation rather than invalidity. In this context *Lajos Vékás* stresses that in the system of the Civil Code the duty to co-operate, including the duty to inform during contractual negotiations and at the time of the conclusion of the contract, may be deemed a so-called *culpa in contrahendo,* that is a fault in the conclusion of the contract. In accordance with the Civil Code, such breach might entail liability to provide compensation. Liability is subject to whether the contract was concluded or not.[28]

The same logic applies to Section 16 (5) of Act CLXII of 2009 on Consumer Credit.[29] As a matter of fact, this section stipulates that if the lack of the relevant content item does not affect the conclusion of the contract, the creditor is obliged to compensate the consumer for damages suffered from the lack of such content item in accordance with the rules on liability for damages due to a breach of contract. Thus, if the creditor failed to include a substantial element in the loan agreement to be concluded with the consumer, but that element does not affect the conclusion of the contract (it is not a substantive element), the contract will be valid, but the consumers may bring action for damages against the creditor on a contractual basis.

When interpreting the requirement of transparency in accordance with Directive 93/13/EEC, one should take into account the doctrinal differences between the obligation to inform prior to concluding the contract on the one hand and the invalidity of unfair contractual terms on the other. Further clarification is needed on when the lack of information qualifies as the breach of the duty to communicate information prior to concluding the contract and when it is to be considered as a not sufficiently clear and intelligible contractual term.

Delimitation between the two, however, is not always easy, since in practical terms the consumer is faced with uncertainties of interpretation of a not sufficiently clear and understandable term that was not explained properly before concluding the contract. In this case the consumer could in principle rely on the fact that if he had received proper information on the contractual term in question, he would have understood its precise meaning and would not have signed the contract.

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28 VÉKÁS: i.m. p. 88.

29 This Act transposed into Hungarian law Directive 2008/48/EC on consumer credit agreements.

This, however, might produce an even more complicated situation as it is typically a case of error.[30] In fact, error can give cause to the contract being challenged, which under Hungarian law is possible within one year of concluding the contract. All in all, often the same information deficiency may result in the breach of the duty to communicate information prior to concluding the contract, in error and in the nullity of the unfair contractual term.

3. Legislative Steps in 2014 with Regard to Foreign Currency Loans

Since consumer loan contracts started to create an increasingly significant social and economic issue in Hungary from 2008, the Hungarian legislature had to take action. Substantive legislative steps were taken after 2010. Moreover, in 2014 within a few weeks of the formation of the new government, the first act on foreign currency loans was adopted, followed by three other acts in the same year. The process was completed in 2015, which resulted in the elimination of consumer loans in foreign currency.

3. 1. The First Act on Foreign Currency Loans

On 16 June 2014 the Hungarian Kúria adopted Integrative Civil Law Decision 2/2014.[31] Subsequently the Parliament adopted Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Kúria in respect of consumer loan contracts entered into with financial institutions (hereinafter: Act DH1). The Act was promulgated on 18 June 2014, barely a month after the adoption of the integrative decision. The majority of the provisions of Act DH1 entered into force on 26 July 2014.

National legislation was justified by the fact that although the integrative civil law decision of the Kúria is binding only upon courts, the principles of law set out therein, affected a wide range of both legal relationships and debtors. Legislation was needed to enforce the relevant requirements. Owing to Act DH1, the provisions of the integrative decision of the Kúria became applicable to all foreign currency debtors, without the necessity of taking legal proceedings.

Most importantly, it avoided hundreds of thousands of lawsuits with regard to the nullity of the so-called exchange rate margin.[32] Section 3 (1) of Act DH1 established: „*In the consumer loan contract, with the exception of the individually negotiated contract term, the clause under which the financial institution applies the buying rate when disbursing the financing for the purchase of the borrowed or leased object, while for the repayment of the debt it applies the selling rate or an exchange rate other than the exchange rate specified when the disbursement was made shall be null and void.*” Subsection (2) added that the clause qualified as null and void under Subsection (1) is to be replaced by a provision prescribing the application of the official foreign exchange rate of the National Bank of Hungary, both

30 Error in continental law is considered as a ground for invalidity. The conclusion of the contract itself is recognized, but it does not have any legal effect. In English and American common law, by contrast, in the case of error the contract may be declared *void ab initio*, i.e. as if the contract was never made. See: MENYHÁRD, Attila: *A szerződés akarathibák miatti érvénytelensége*. Eötvös Loránd Tudományegyetem Állam- és Jogtudományi Kar, Polgári Jogi Tanszék, Budapest, 2000. p. 16-29.

31 In the subject of the unfairness of certain provisions of foreign currency-based loan contracts not addressed by 6/2013 PJE.

32 In Hungary 180.000-200.000 civil law cases are initiated. Source: National Office for the Judiciary (OBH)

in terms of disbursement and repayment (including the payment of the instalment and any cost, fee or commission denominated in foreign currency). Finally, Section 3(5) in this respect also stated that the financial institution is obliged to make a settlement with the consumer as specified in a separate Act.

A further important aspect of Act DH1 is that Section 4 established a rebuttable presumption of the unfairness of contractual clauses providing for the opportunity to amend the contract unilaterally. Section 4 transposed the criteria specified in the Kúria's integrative decision.[33] In this respect the Act allowed financial institutions to prove the fairness of their clauses on the unilateral amendment of the contract under an expedited procedure.

Section 4(3) laid down the settlement obligation of the financial institution: if the court established the nullity of the contractual clause providing for the opportunity to amend the contract unilaterally, the financial institution is obliged to make the settlement with the consumer in the manner defined in a separate Act. It is to be pointed out that this clause does not only apply to loans in foreign currency, but also to forint-based consumer loan contracts.

Act DH1 laid down special provisions for managing pending actions. Pursuant to Section 16 these should be suspended. Data provided by the National Office for the Judiciary show that 13.268 actions were suspended pursuant to Act DH1. Proceedings the subject of which, in part or in full, was a contract clause on exchange rate margins and on the opportunity to unilaterally amend the contract had to be suspended. These were typically actions for a declaration initiated pursuant to Section 239/A (1) of the Civil Code of 1959.[34]

Whereas Section 17 of Act DH1 contains special provisions on judicial enforcement, Section 18 provides for the suspension of the sale of pledged lien outside judicial enforcement.

It should be noted that Act DH1 takes an unambiguous stance on the expiry of claims originating from consumer loan contracts. In fact, in accordance with Section 1 (6) of the Act the provisions of the Civil Code of 1959 concerning the statute of limitation in the case of claims arising from consumer loan contracts should be interpreted in a way that such claims do not expire during the existence of the loan contract, the limitation period shall commence when the contract terminates. The legislature intended to eliminate an uncertainty in applying the law. Although this solution has later come under criticism in legal literature,[35] in our opinion the act codified the correct doctrinal solution. A similar position was adopted by the German Federal Supreme Court (BGH) with regard to German law. BGH's ruling of 28 October 2014 (BGH XI ZR 17/14) examined the administrative fee charged at the time of concluding the consumer loan contracts.[36] In its ruling on the time period of the redeemability of the administrative fee the BGH stated that the limitation

33 The issue of the unfairness of the right to amend a contract unilaterally was raised in the context of non-consumer contracts well. In this connection the Regional Court of Szeged ruled in a specific case that the criteria for establishing the unfairness of unilaterally increasing interest are applicable mutatis mutandis to non-consumer loan contracts. (ÍH 2016. 136.).

34 Section 239/A (1) of the Civil Code of 1959 stipulated that: *„The party may bring action asking the court to declare a contract or specific clauses of the contract invalid (partial invalidity) without requesting the application of the legal consequences of the invalidity."* This heavily criticised provision was taken over by Section 6:108 (2) of the Civil Code.

35 István, GÁRDOS: *A kölcsönszerződésből fakadó követelések elévülésének kezdő időpontja.* Jogtudományi Közlöny, 9/2014. p. 387-399.

36 This ruling was immediately preceded by another ruling of BGH on 13 May 2014 (BGH XI ZR 170/13.).

period can only commence when all the necessary circumstances occur. Thus, also according to the BGH, the limitation does not commence on the date of the conclusion of the contract, either.

At last, it also worth mentioning that in its Decision 34/2014 (14 November) the Constitutional Court rejected the initiative of judges to establish that Act DH1 was not in harmony with the Fundamental Law of Hungary and to annul it. The Constitutional Court ruled among others that Act DH1 did not constitute retroactive legislation.

Concerning the limitation period, the Constitutional Court stressed that consumer loan contracts tend to be long-term integrated contractual legal relationships between parties that lay down the parties' mutual rights and obligations. Despite the differing views expressed in legal literature, from the aspect of constitutionality the acceptable position is that in these cases claims alone cannot be extinguished during the existence of the contract. In order to handle the legal relationship as a single unit, through the Act the legislature gave an interpretation that is similar to the one applied to paying instalments in leasing agreements, according to which limitation only begins when the contractual relationship terminates pursuant to the contract. This does not contradict the limitation rule defined in the Civil Code of 1959. Namely while the debtor's liability towards the financial institution (and the claim of the financial institution towards the debtor) subsist, the limitation of the individual payments and claims cannot commence independently of each other, that is the claims with regard to the payments made by the debtor may not lapse. [Section 136 of CC Decision 34/2014 (14 November)].

3. 2. Settlement Act

Act DH1 had already foreseen that financial institutions would have to repay to their debtors the amounts that they realized through applying unfair contractual terms. A separate Act was adopted on the settlement of (past) overpayment by consumers linked to unfair contractual terms (hereinafter: Act DH2).[37]

Section 5 (2) of the Act laid down the principles of settlement. In accordance with this, the consumer's claim should be calculated according to the decree issued by the Governor of the National Bank of Hungary upon the authorisation of this Act as if overpayments had been paid as prepayments at the time of overpayment.

The legislature could have chosen among a number of settlement methods. Out of these the most favourable one for the consumer is the so-called settlement based on prepayment. This implies that overpayment should be credited to the debtor as prepayment of the outstanding amount. The argument that prepayment is only possible of the free will of the debtor could not be brought up against this method. In fact, in this case the issue of prepayment does not even arise as the debtor had not been aware at the time of paying the due instalment that he was paying in excess. Overpayment was recognized by the debtor only subsequently and it is to be assumed that he would wish the overpayment to offset part of the outstanding amount.

Owing to settlement based on prepayment, the profit arising from the previously applicable favourable exchange rate was realized directly by the debtors. As a general rule, in accordance with the settlement method based on prepayment, the consumer must be placed in a position

[37] Act XL of 2014 on the rules of settlement regulated in Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Kúria respect of the consumer loan contracts entered into by financial institutions, and certain other provisions.

as if settlement had occurred at the rate specified in Section 3 of Act DH1 and at the original interest rate (prior to raising the interest rates) applicable at the time of concluding the contract.

In the event that the repayment of the debt was defined in a foreign currency, overpayment should also be converted to that currency. In doing so, overpayment should be accounted for at the rate that was used by the financial institution for converting the outstanding amounts, that is the capital repayments and the interest payments.

In case the consumer had overdue debts vis-a-vis the financial institution, the settlement of the overpayment is governed by Section 293 of the Civil Code of 1959 (Section 6:46 of the Civil Code). In this case the sum constituting the overpayment should be used for paying the costs first, then the interest, and, finally, the principal debt.

With regard to the above the Settlement Act covers the following questions:

- the manner of the settlement;
- the procedure of the settlement;
- specific rules applicable to forint loans as well as consumer loan contracts registered in foreign currency and disbursed in foreign currency;
- special procedural provisions governing suspended legal actions and enforcement proceedings;
- 18-month moratorium on interest rate increases;
- provisions on accounting and taxation;
- provisions on the necessary amendment of Act DH1.

In a number of cases Act DH2 introduced deferring accounting rules:

- on consumer loan contracts in the case of early final repayment;
- regarding consumer loan contracts affected by residential properties offered to the National Asset Management Company for purchase;
- in case of consumer loan contracts affected by the exchange rate cap;
- regarding consumer loan contracts affected by bridging loans.

Act DH2 also laid down the time limit for complying with the settlement obligation. Irrespective of this clause, however, for foreign currency credits and foreign exchange-based loan contracts the effective date of settling the consumer's claim was 1 February 2015. For forint-based credits the effective date of settling the claim was 30 June 2015.

As for the revision of the settlement, Act DH2 stated that should the consumer dispute the contents of the settlement issued by the financial institution, he may first submit a complaint to the financial institution. If the complaint is rejected, the consumer could initiate the proceedings of the Financial Arbitration. The consumer may initiate a non-contentious civil proceeding against the Financial Arbitration Board's decision to terminate the proceedings or to establishing the correct settlement.

Specific rules apply to proceedings launched by actions in the public interest. These could be launched by the National Bank of Hungary if the General Terms and Conditions published after 26 November 2010 were amended or the previous General Terms and Conditions were modified after this date. As a matter of fact, in these cases unfairness of the contractual terms allowing for unilateral amendment was not to be presumed.

Section 37 of Act DH2 intended to remedy the abusive exercising of rights originating from the opportunity granted by Section 239/A (1) of the Civil Code of 1959.[38] Act DH2 therefore stipulated that in respect of contracts falling under the scope of this Act, the party may request the establishment of the invalidity of the contract or of certain contractual provisions (partial invalidity) from the court, irrespective of the reason for invalidity, regarding the application of the legal consequences of invalidity, that is to declare the contract valid or effective until the date when the decision is made. If the party requests the legal consequence of invalidity or partial invalidity to be deducted, he shall also indicate the legal consequences the court shall apply. This provision was examined by the European Court of Justice in its Judgement in Case C-118/17. A detailed analysis thereof will follow below in 4.2.

According to the data provided by the National Bank of Hungary of 1 October 2015, following the settlement, an average amount of HUF 393.000 (EUR 1.200) that had been unfairly incurred was reimbursed to the debtors by the Hungarian financial institutions. The amount was HUF 718.000 (EUR 2.240 EUR) in the case of mortgage loans and HUF 201.000 (EUR 630) with respect to non-mortgage loans. The sums charged in an unfair manner amounted to HUF 734 billion (EUR 2,3 billion). As a result of the settlement the outstanding debts of the consumers decreased by HUF 550 billion (EUR 1,7 billion).

While the average monthly instalment of Swiss franc-based mortgage loans decreased by HUF 26.154, that is by 25%, the average principal (not yet due) debt dropped from HUF 8 million to HUF 6,5 million (that is by HUF 1,5 million – EUR 4.700). The level of interest rates fell to an even greater degree: for Swiss franc-based housing loans interest rates dropped from 5,85 % to 4,28 %, that is on average became 27 % lower after the settlement. The interest rate level of EUR-based housing loans decreased by 22 %. The slightest decrease occurred in Japanese yen-based housing loans: here the level of interest only dropped by 3 %.

The monthly instalments of 85% of foreign currency-based loan contracts decreased at the time of the settlement. Owing to the settlement by banks, the amount of omnibus credit contracts fell by 92% (by 140.000 contracts and thus their number was reduced to 13.000).

In Hungary in the wake of the Settlement Act, more than a total of 2,2 million claims were settled. As a result of the settlement, 66.196 claims lapsed. Most of the contracts and claims affected by settlement were car loans.

3. 3. New Criteria for Credits Provided for Consumers: The 'Fair Banking Act'

The problems of the foreign currency borrowers have drawn attention to the rules on consumer credits and their deficiencies. Consumer credits constitute a special group of credits and differ essentially from credits provided to corporate clients in several respects. The significance of consumer credits is proven by the fact that this area had been regulated by a Directive within the European Economic Community as early as in 1987. This was replaced by Directive 2008/48/EC, which was transposed in Hungarian law by Act CLXII of 2009 on Credit Provided to Consumers (hereinafter 'Fair Banking Act'). The Fair Banking Act entered into force on 1 March 2010.

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[38] This possibility is also secured by Section 6:108 (2) of the Civil Code.

Since the entry into force of the Fair Banking Act in 2010, Hungarian courts have dealt with a number of consumer credit cases. The recent developments in case law as well as the previous acts to support debtors in foreign currency necessitated the amendment of the Fair banking Act in 2014.[39]

The primary objective is to make sure that banks offer credits to consumers under fair contractual terms that are transparent to consumers themselves. The amendment of the Fair Banking Act therefore contains the following provisions:

- defines new, transparent rules for unilaterally modifying consumer loan contracts: the new provisions cover the unilateral raising of interest rates, charges and costs;
- sets out in detail and renders more efficient the duty of the creditor to communicate information prior to concluding the contract, with the main aim of enabling the consumer to take an informed decision on the possible conclusion of the credit agreement and on the risks involved;
- offers the consumer a free of charge termination right if the credit has already been disbursed: the objective is to facilitate bank switching and competition between banks;
- maximizes late interest rates: the purpose is to prevent creditors from applying usury-like interest rates to debtors already struggling with payment difficulties;
- extends the duty of the creditor to inform prior to concluding the contract to the surety and to the lien obligator: the aim is to make sure that these consumers, who are different from the main borrower, can also make an informed decision on offering the guarantee;
- encourages the Hungarian Banking Association to work out a sample general business rules for its members in order to ensure that banks provide loans based on standard contractual terms, which helps the consumer make their choice among these credit products and renders contractual terms more transparent.

The Act amending the Fair Banking Act was primarily designed to give greater protection to consumers suffering from a lack of information. The legislature nevertheless formulated certain requirements vis-a-vis the consumer, too. Although it is clear that in consumer credit transactions the consumer is the weaker party due to his economic situation and information asymmetry, the consumer can still be expected to gather appropriate information. Circumspect, prudent behaviour can be expected from the consumer as well, especially when he is about to offer his residential property as security for a loan agreement spanning several decades. In this respect the amending act stipulates that the provisions of the Fair Banking Act should be applied in compliance with Section 6:62 of the Civil Code on the mutual obligation of parties to cooperate and communicate information.

As a result of evolving case law, the legislature amended Section 16 (5) of the Fair Banking Act. In accordance with the earlier rule, the lack of any content requirement defined in the Act led to the invalidity of the consumer loan agreement as a whole. The invalidity of the entire contract, however, does not favour consumers either, as in this case they would be obliged to repay the debt, together with interest and charges, in one amount. To avoid this, the relevant provision of the Fair Banking Act was replaced by the following: *„If the lack of*

[39] Act LXXVII of 2014 on amending Act CLXII of 2009 on credit provided for consumers and other related acts.

any content item under this Section does not affect the coming into being of the agreement, the creditor shall compensate the consumer for any loss that may arise from the content deficiency of the agreement under the rules of liability for losses caused through a breach."

It is worth noting that besides taking into account the evolvement of domestic case law, the Hungarian legislature also paid attention to legal developments in Austria and Germany.[40] Furthermore, the provisions of Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property were also considered.

It is on this basis that the new Section 13 (1) of the Fair Banking Act set out that if mortgage credits and financial leasing relating to real estate are requested, the draft agreement should be placed at the consumer's disposal minimum seven days prior to the conclusion of the agreement even without the consumer's request.

3. 4. Act on Conversion into Forints

3.4.1. The Purpose of the Act and its Main Provisions

The legal measures serving to protect the debtors of foreign currency-based consumer loans were completed by the Acts on the conversion into forints of mortgages in 2014[41], and of car loans and personal loans in 2015,[42] respectively.

The law of 2014 on the conversion into forints of mortgages was conceived with a dual objective in mind:

- to end the exposure of consumers with a foreign currency debt to exchange rate fluctuations,
- to secure the stability of the financial architecture by eliminating currency exchange risks.

The law gave rise to the amendment of contracts through legislation, since the currency in which the debts had been held was modified ex lege.

The revaluation of outstanding liabilities did not lack precedent in Hungarian law history. The economic crises of the 20th century actually provide a number of examples for similar revaluations through law. One of the most significant among these has been Law Article XII of 1928 on the revaluation of certain pecuniary debts under private law. In fact, the revaluation carried out on the basis of the 1928 Law was not limited to simple conversion, as it also extended to the restoration of the value equilibrium between the services of the parties along fair criteria.[43] This shows that revaluation of the outstanding debts occurred during major economic crises in order to facilitate recovery.

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[40] See: BODZÁSI Balázs: A *bankkölcsönszerződésekben kikötött kamat módosítására vonatkozó szabályok a német és az osztrák jogban*. Magyar Jog, 2/2013. p. 103-116.

[41] Act LXXVII of 2014 on the settlement of issues related to the conversion of the currency of certain consumer loan agreements and rules regarding interest.

[42] Act CXLV of 2015 on the Settlement of certain issues related to the conversion of claims arising from certain consumer loans to forint.

[43] See details thereof in CZUGLER, P. Áron: *Hitelválságok kezelése egykor és most. A bethleni konszolidáció magánjogi válságjogának tanulságai a jelenkor számára*. Jogtudományi Közlöny, 1/2015. p. 40.

The primary purpose of the conversion act therefore was to eliminate the burdens associated with future exchange rate risks in the otherwise valid loan contracts. This was achieved by defining the exchange rate. Under Section 10 of the Act: *„The financial institution that is the beneficiary of the given foreign currency or foreign currency-based mortgage loan agreement shall, by the deadline for the fulfilment of its obligation of settlement under the Settlement Act, convert the total debt existing on the basis of or arising from the foreign currency or foreign currency-based consumer mortgage loan agreement as determined on the basis of the settlement rendered in accordance with the Settlement Act, including any interest, fees, commissions and costs charged in a foreign currency, into a forint claim as of the effective day at one of the following exchange rates, whichever is more favourable for the consumer:*

a) the average of the foreign exchange rates of the given currency officially quoted by the MNB between 16 June 2014 and 7 November 2014, or

b) at the foreign exchange rate of the given currency officially quoted by the MNB on 7 November 2014 (hereinafter referred to as „forint conversion")."

In defining the conversion rate it had to be taken into account that Integrative Decision 2/2014 of the Kúria concluded that in valid loan contracts exchange rate risks are to be borne by the debtor. A further consideration was that interest on foreign currency and foreign currency-based loans had always been lower than that of forint-based loans provided for the same purpose. It had to be ensured that borrowers with loans in forint could not get into unfairly disadvantageous situation compared with debtors in foreign currency and foreign currency-based loans. The exchange rates applicable to conversion into forints set out in the Act validated this aspect, too.

The Act on conversion into forints, following past examples, did not merely stipulate the conversion into forints of the existing foreign currency debts. In fact, defining the initial interest in forints of loans converted into forints was just as essential as defining the exchange rate. Thus, Section 11 of the Act laid down that for debts converted into forints a reference interest rate should be applied that must consist of the three-month BUBOR and the interest margin featured in the original loan contract. The act also specified the interest margin: The interest margin cannot be less than 1 per cent, and may not exceed 4,5 per cent in the case of housing consumer mortgage loan agreements or 6,5 per cent in the case of non-housing consumer mortgage loan agreements.

In addition to defining the initial interest in forints following the conversion, the Act also specified how often repricing may occur in the light of the residual maturity, that is, at what intervals the financial institution may increase the interest rate. In this connection Section 8 of the Act set forth that interest in the future may only be altered in accordance with the provisions of the Consumer Credit Act.[44]

The purpose of the legislature had equally been to avoid banks defining the highest permitted interest in the loan contracts, but to create competition in defining the interest and other charges of the existing contracts. Therefore Section 13 of the Act enabled the consumer to terminate the loan contract free of charge if another financial institution offered lower interest on loans and to conclude a contract with the financial institution offering more favourable credit conditions.

[44] The relevant provisions of the Consumer Credit Act were amended by Act LXXVIII of 2014.

In addition to existing loan contracts, conversion into forints of outstanding debts for certain terminated contracts also took place (Section 15). The aim was to stop the further increase of the total debt (that had given rise to a number of enforcement proceedings against debtors) due to unfavourable currency fluctuations.

It is to be highlighted that subject to certain conditions, the Act opened up the possibility for consumers to request the dispensation of converting the debt originating from the loan contract into forints. This provision is included in Section 12 of the Act. Maintaining foreign currency (and foreign currency-based) loans might have primarily been advantageous for debtors who either received their income in a foreign currency or the remaining repayment period was short or else their outstanding foreign currency debt was insignificant compared with their income. In the case of debts originating from already terminated loan contracts the Act did not fix any conditions, which means that dispensation of the forint conversion could be requested without restriction. In this regard Section 15 (3) of the Act sets out that if initiated by the consumer in writing, within 30 days of the receipt of the notification of the financial institution, the financial institution was obliged to re-convert the claim converted into forints into a claim denominated in the original currency at the exchange rate determined in Section 15 (1).

The Act also established that in the case of loan contracts not affected by conversion into forints, the financial institutions should revert to the originally calculable interest or interest margin. In accordance with Section 14: „*In the case of forint-based consumer loan agreements and foreign currency and foreign currency-based consumer loan agreements not provided against mortgage security, the interest or interest margin applicable as of the effective day may not exceed the originally calculable interest or interest margin.*"

Thus, the existing contract became amended by the power of law. The Act did not prescribe any obligation binding the consumer in this respect. The financial institutions sent the notification on the conversion of the debt into forints to the debtors together with the notification on having fulfilled the settlement obligation.

The Act did not establish any presumption as to whether the loan contract was otherwise valid. As a consequence, the Act did not remedy retroactively the grounds for invalidity that might have existed at the time of concluding the loan contract. By requiring the conversion of the debt into forints in the case of foreign currency and foreign currency-based loan contracts provided against mortgage security, the Act eliminated future exchange rate risks.

The advantages and proper timing of the Act on conversion into forints were highlighted in particular by the decision of the Swiss National Bank in early 2015 to scrap the euro cap on the Swiss franc.

3.4.2. Decision 33/2015 (03 December) of the Constitutional Court Assessing the Act on Conversion

The Hungarian Constitutional Court received hundreds of submissions (constitutional complaints) concerning the Act on Conversion into Forints. The Constitutional Court handled the submissions jointly. The resulting Decision 33/2015 (03 December) first and foremost examined whether the constitutional conditions for amending contracts through the Act on Conversion into Forints (i.e. by legislation) existed.

The Constitutional Court first established that the provisions of the Act laying down the provisions for mandatory conversion into forints of debts originating from contracts falling within the scope of the Act clearly constituted an intervention in the contractual freedom of the requesting parties (complainants). The contracts affected by the Act on conversion into forints were amended for reasons beyond the parties' control, partly without any further legal action, partly through mandatory rules binding the parties. Consequently, the ex-post amendment of rights and obligations arising from concluded contracts with legislative measures, imposing the obligation to convert foreign currency debts into claims denominated in forints, was clearly an intervention in the contractual freedom of the parties. The Constitutional Court, however, did not deem the intervention to be necessarily incompatible with the Fundamental Law of Hungary.

The constitutional conditions for exceptional legislative intervention were developed by a series of the Constitutional Courts' previous decisions in order to ensure the amendment by legislation of long-term contractual relationships. In this regard, in its key Decision 8/2014. AB (20 March) the Constitutional Court established that long-term private-laws contracts could be amended by legislative measures only when the requirements of the clausula rebus sic stantibus principle are met.

The primary objective of the legislation making the conversion of foreign and foreign currency-based loans mandatory was to eliminate the exchange rate risk for consumers (as debtors) for the future since this has put an unpredictable and heavy burden on them. In accordance with Section 45 of the recital Constitutional Court Decision (hereinafter CC Decision): *„The unpredictability of possible future exchange rate fluctuations meant such uncertainty for debtors that in view of the large number of debtors threatened with the risk of significant financial and social loss for the entire society. The aim of avoiding such risk provides the legislature with constitutional grounds to intervene, primarily in the debtors' interest (It should be noted that the mandatory conversion into Hungarian forints was performed primarily in the debtors' interest as it eliminated future exchange rate risk). It must be emphasized that by ordering the mandatory conversion in Hungarian forints[…] the legislature did neither interfere with the outcome of ongoing individual court proceedings, nor did it take a decision on the validity/invalidity of individual contracts (or contractual clauses)".*

Besides the protection of debtors, the other aim of legislative intervention was to protect creditors. From the point of view of constitutionality, the key interest that the legislature had to take into account was to close the creditors' open foreign currency positions. In fact, the creditors had to close their open foreign currency positions as soon as possible, which required the conversion of the largest possible number of foreign currency-based contracts to Hungarian forints. Thus, one of the objectives of conversion into Hungarian forints, beyond protecting consumers, was to reduce the exposure of creditors as much as practicable. Additionally, the protection of the creditors led to the protection of the depositors indirectly. In that respect the Constitutional Court stated: (Section 47 of the recital of the CC decision): *„Failure to convert the foreign exchange debts into forints or delaying their conversion represents a systemic risk for Hungary because of the large number of foreign exchange loan contracts and the size of the outstanding debt. Without eliminating this situation, a significant weakening of the Hungarian forint could have been expected, which would have further ruined the financial situation of the debtors."*

As far as conversion into forints is concerned, it should be remembered that the Act had provided for „opting out", that is it allowed debtors to request the dispensation of the forint conversion under certain conditions. In the case of existing contracts, nevertheless, this was not only subject to the consumer's choice, but was tied to certain conditions in Section 12(3) of the Act. In the case of already terminated contracts, on the other hand, the Act provided for the dispensation of the forint conversion of debts arising from these contracts more widely. With respect to these contracts, Section 15 (3) of the Act provided for opting out from forint conversion without restriction.

The Constitutional Court stressed that in formulating the rules of conversion into forints, the legislature had to keep in mind the interests of not only debtors, but those of creditors and their depositors as well. Recital 54 of the CC Decision underlines: *„The primary objective of intervention was to ensure the implementability of the contract, this was the reason for which the effect of exchange rate fluctuations on the payment obligation of debtors had to be eliminated, which serves the interests of all the subjects of the contractual relationship , and at the level of national economy, the interest of the financial sector. The high percentage of foreign currency or foreign currency-based loan contracts out of the total number of contracts also represented a risk for creditors and thereby for the stability of the financial system. The element of the legislation that provides affected consumers with only a limited dispensation of the process of conversion into forints in the case of existing contracts should be considered in this light. A review of the exceptions reveals that they only concern the particular cases in which conversion into forints would have actually been unreasonable and specifically unfavourable for the debtors. (the debtor receives his income in the foreign currency of the debt, he would be eligible for taking a foreign currency-based loan at the time of conversion into forints, the contract is for a short or medium term etc.). Such contracts represent only a smaller percentage compared to the total number of contracts, their non-conversion does not place the affected creditors at a disadvantage and therefore their continuation cannot represent a risk to the stability of the country's financial intermediaries, either"*

All in all, the Constitutional Court stated that the legislature decided to convert the debts affected by the Act into forints out of general social interest, due to a change in circumstances involving the overriding of compelling and legitimate interests in the wake of the conclusion of the contracts. In drafting the Act, the legislature took due account of both the contractual freedom of the consumers to be protected and of the interests of the other party, the creditors, affected by the legislative intervention in order to restore the economic equilibrium of the relevant contracts. In the view of the Constitutional Court the fact that the legislature did not provide consumers the opportunity for opting out of the process of conversion into forints without limitation and ensured it only to those who would have indeed been affected negatively, met the criterion of rationality.

Based on the above, the Constitutional Court rejected constitutional complaints seeking to establish the non-constitutionality and the nullity of the contested provisions (Section 10 and 15) of the Act on conversion into forints.

4. Recent Case-Law of the European Court of Justice in Connection with Hungarian Foreign Currency Loan Cases

The integrative civil law decisions of the Kúria as well as the rules laid down by the Hungarian legislature failed to put an end to legal issues arising from foreign currency lending in Hungary. In fact, since 2013, Hungarian courts initiated a number of requests for preliminary ruling from the EJC. In view of the decisions taken in these cases, Hungarian debtors brought new actions before Hungarian courts. In the meantime, the ECJ has further developed its own case law on loan contracts in foreign currency. In the following we will summarize the most recent decisions of the ECJ as well as their legal impact on Hungarian debtors and Hungarian law.

4. 1. Judgment in Case C-51/17 (20 September 2018)

4.1.1. Facts of the Main Proceedings

On 15 February 2008 the borrowers concluded a loan agreement denominated in Swiss francs with a Hungarian bank. Paragraph 4.7.1 of the loan contract stated that *„The debtor is required to fulfil the payment obligations to which he is subject, denominated in the currency of the loan, by transfer of the exchange value in Hungarian forints to the "credit" account … opened with for the purposes of this loan. The debtor is required to fulfil the applicable payment obligations at the latest on the day the debt becomes due, in accordance with the selling rates of the currency concerned, published under the provisions of the internal regulations, ensuring to replenish the account referred to above, at the latest on the due date, up to the exchange value in Hungarian forints. The creditor shall convert into Hungarian forints the debtor's payment obligations denominated in a foreign currency in accordance with the rates referred to in this paragraph on the due date and it shall debit that sum from the "credit" account in Hungarian forints […]."*

Paragraph 10 of the loan contract at issue, entitled 'Declaration of notification of risk', was worded as follows:

'In relation to the loan risks, the debtor declares that he is aware of and understands the detailed information relating to this matter provided to him by the creditor, and is aware of the risk of taking out a foreign currency loan, a risk which he alone bears. With regard to the foreign exchange risk, he is aware, in particular, that, if during the term of the contract there were variations in the exchange rate between the Hungarian forint and the Swiss franc which were unfavourable (that is to say, in the event of depreciation of the exchange rate of the Hungarian forint as opposed to the exchange rate at the time of disbursement), it might even happen that the exchange value of the repayment instalments, which are fixed in foreign currency and payable in Hungarian forints, would increase significantly. By signing this contract, the debtor confirms that he is aware that the economic repercussions of this risk lie entirely with him. He also declares that he has carefully assessed the possible effects of the foreign exchange risk and that he accepts them, having weighed up the risk in the light of his solvency and economic situation, and that he will not be able to make any claim on the bank as a consequence of the foreign exchange risk.'

On 16 May 2013 the borrowers brought an action before the Fővárosi Törvényszék (Budapest Regional Court, Hungary) for annulment of the loan contract at issue on the ground, inter alia, that they were not able to evaluate the extent of the foreign exchange risk, since the contractual term concerned had not been drafted in plain intelligible language. Furthermore, on 22 July 2013 the bank terminated the loan contract owing to the borrowers' failure to perform it.

The Fővárosi Ítélőtábla (Regional Court of Appeal, Budapest) upheld the borrowers claim by judgment of 11 March 2016. It noted, first, that the conclusion of a loan contract in a foreign currency was at the time more favourable and cheaper than that of a contract denominated in Hungarian forints. Secondly, it underlined that the bank should have been aware *„having regard to the incipient economic crisis, that recourse to the Swiss franc as a safe-haven currency presented considerable risks"*. The bank failed to warn the borrowers in that regard. In addition, the contractual term relating to the foreign exchange risk was not drafted in plain intelligible language. On the basis of the above, that court decided to convert the borrowers' outstanding debt into Hungarian forints, as if the loan contract at issue had been denominated in that currency.

Following an appeal, the Fővárosi Ítélőtábla (Regional Court of Appeal, Budapest) decided to stay the proceedings and to request a preliminary ruling from the European Court of Justice. The Regional Court of Appeal addressed altogether five questions to the European Court.

With respect to the third relevant issue for the purposes of the present study the European Court of Justice clarified that the borrower must be clearly informed of the fact that, in entering into a loan agreement denominated in a foreign currency, he is exposing himself to a certain foreign exchange risk which will, potentially, be difficult to bear in the event of a depreciation of the currency in which he receives his income in relation to the foreign currency in which the loan was granted. On the other hand, the seller or supplier, in this case the bank, must be required to set out the possible variations in the exchange rate and the risks inherent in taking out a loan in a foreign currency.

With respect to the third question the European Court (ECJ) affirmed that Article 4(2) of Directive 93/13/EEC must be interpreted as meaning that the requirement for a contractual term to be drafted in plain intelligible language cannot be reduced merely to it being formally and grammatically intelligible to borrowers in order to make informed and well-founded decisions. This requirement implies that a term relating to the foreign exchange risk must be understood by the consumer both at the formal and grammatical level and also in terms of its actual effects. As a result, the average consumer, who is reasonably well informed and reasonably observant and circumspect, would not only be aware of the possibility of a depreciation of the national currency in relation to the foreign currency in which the loan was denominated, but would also be able to assess the potentially significant economic consequences of such a term with regard to his financial obligations.

It is against this background that the Regional Court of Appeal of Budapest as referring court will have to decide whether the information received from the creditor complies with the criteria laid down by the European Court. Should the regional court deem the information provided to debtors inappropriate and therefore rule on the unfairness of the relevant General Terms and Conditions that might entail the invalidity of the entire loan contract. A further question is which of the legal consequences will be applied by the Hungarian court in this case. Nonetheless, the ECJ stated that judging from the available data, the borrowers received among others an information sheet relating to the foreign exchange risk, containing examples of specific calculations of the risk in the event of a depreciation of the Hungarian forint in relation to the Swiss franc (see Section 77 of the Judgement).

4.1.2. Implications for Hungarian Law

4.1.2.1. Position of the Consultative Body of the Kúria

The Consultative Body set up by the Chairman of the Kúria to assess jurisdictional issues that arose in connection with lawsuits claiming the invalidity of foreign-currency loan agreements held a meeting on 10 October 2018. In interpreting Judgement C-51/17 of the ECJ, the Consultative Body came to the conclusion that it did not contain any new elements that had not been already developed by the European Court of Justice and that had not been taken into consideration by the Kúria in its law uniformity efforts. The Consultative Body stated that for the time being there was no need for the Kúria to issue new, general guidelines or to amend former ones.[45]

At its more recent meeting of 10 April 2019, the Consultative Body of the Kúria added that in line with the statements on the unfairness of the information provided in judgements in cases C-26/13, C-186/1 and C-51/17, the guidelines set out in the integrative civil law decisions of the Kúria continue to be valid (Paragraph 3 of Judgment 6/2013 PJE, Paragraph 1 of Judgment 2/2014 PJE). In order to judge whether the information furnished on exchange rate risks was fair or not in a given case, all the available evidence needs to be considered, therefore no further general mandatory guidelines may be issued to the courts through law uniformity decisions in this subject.

The Consultative Body established that failure to provide information or furnishing inappropriate information on the exchange rate risks that lie with the consumer („not plain, not intelligible"), the provision of the contract which states that the exchange rate risks are borne by the consumer is invalid. Since this contractual provision concerns the principal supply of services, its invalidity entails the invalidity of the entire contract, as a result the consumer cannot be obliged to bear the exchange rate risks.

If bearing the exchange rate risk can only be inferred from certain clauses of the contract or through the joint interpretation of several documents (e.g. GTC, business rules, advertisement), that does not qualify as appropriate communication of information. The fact that the information sheet on exchange rate risks and the contract are signed simultaneously cannot be challenged if the party had sufficient time at his disposal to study it prior to signing the contract.

According to the Consultative Body the fact that the consumer did not act with due diligence caution, does not prevent him from claiming that the financial institution failed to meet its obligation to provide information or provided it in an inappropriate manner. In order to judge whether the consumer acted with due diligence when he did not request further information from the financial institution, one has to take into account the potentially ambiguous, vague and complicated wording of the contract for the average consumer.

As set forth in the guidelines of the EJC, information is adequate if it is apparent from it that unfavourable exchange rate fluctuations to be borne by the customer are without any upper limit, which means that instalments may increase considerably as well as that the possibility of exchange rate fluctuations is a realistic scenario, which might occur during the term of the contract. The information should not only unambiguously clarify that exchange

[45] The memorandum of the meeting of10 October 2018 of the Consultative Body of the Kúria is available in Hungarian at: http://kuria.birosag.hu/sites/default/files/konz_testulet/sajtokozlemenyc-51.17_masolata_0.pdf

rate fluctuations are to be reckoned with, but also that this implies risks which are not to be neglected and which might increase the repayment instalments significantly.

Another key statement of the Consultative Body is that if the upper limit of the expected exchange rate increase or its highest order of magnitude can be inferred from the plain and intelligible written or oral information, the consumer is liable for the exchange rate risks only the degree defined therein.[46] This is line with the judgement of the Regional Court of Debrecen (Debreceni Ítélőtábla) referred to previously, according to which in the event that the consumer may come to the conclusion from the information given at the time of concluding the contract that there is an upper limit to his exposure to exchange rate risks, any degree of risk-taking exceeding this limit is invalid (ÍH 2017. 56).

4.1.2.2. The Requirement of Conduct to be Expected from the Consumer

It is essential to stress once again from a doctrinal and practical viewpoint that, just as in former judgements, in the judgement handed down in case C-51/17 and in the recital of the judgement, incompleteness of information provided prior to the conclusion of the contract is confused with the not plain and not intelligible general (and individually not negotiated) contractual clause of the specific general term of the contract (lack of transparency).

In accordance with Paragraph 76 of the Judgement, as stated in Recital 20 of Directive 93/13, the consumer should actually be given an opportunity to become acquainted with all the terms of the contract. The ECJ stresses that information, provided in sufficient time before concluding a contract, on the terms of the contract and the consequences of concluding it, is of fundamental importance for a consumer in order to decide whether he wishes to be bound by the terms previously drawn up by the seller or supplier.

The statement of the European Court is incontestable. It should be added, however, that the consumer himself is also obliged to enquire about the contractual terms and the consequences of entering into the contract. In this respect he cannot exclusively rely on information received from the other party prior to concluding the contract. A certain level of obligation to inquire can be expected from the consumer too. As Lajos Vékás put it: the duty to inform only complements circumspect, prudent action that is required from everyone in conducting his own affairs.[47]

It is conceivable that he had not received adequate information from the other party prior to entering into the contract, but he himself took the necessary steps, obtained the relevant information and thereby came to understand the contractual terms and the consequences of signing the contract.

In this regard we agree with the statement of the referring court in Case BDT 2013. 2889 that in accordance with the requirement of good faith and fairness and with the duty to cooperate, having regard to the nature of the long-term contract, the huge amount and risk involved, it can be expected from the consumer to gather information prior to concluding the contract. He should study the sheet containing the contractual terms with reasonable

[46] The memorandum of the meeting of 10 April 2019 of the Consultative Body of the Kúria is available in Hungarian at: https://kuria-birosag.hu/sites/default/files/konz_testulet/emlekezteto_deviza_20190410.pdf

[47] VÉKÁS: i.m. p. 88.

care expected from the average consumer and if he notices a provision that he does not understand, he should ask for proper explanation.[48]

On the basis of the above, the findings of Recital 76 of the Judgement of the EJC that couples the opportunity to examine all the terms of the contract with information provided to the consumer before the conclusion of the contract should be supplemented. In fact, the consumer is also liable with respect to the opportunity to examine the contractual terms.

It is also questionable whether the not plain and not intelligible nature of a(n individually not negotiated) contractual term can be established based on the incompleteness of information provided before the conclusion of the contract. Although the information provided to the consumer prior to concluding the contract might have been incomplete, the relevant provision in the enacted contract can still be clear and understandable. The Declaration of Notification of Risk in Paragraph 10 of the loan contract in question contains fairly concrete and detailed information on the dangers of exchange rate risks to be borne by the consumer. This fact is established in recital 77 of the ECJ judgement. It would be difficult to argue that Paragraph 10 of the loan agreement is not clear and not intelligible for the average consumer who is reasonably well-informed, observant and circumspect, and therefore it is unfair. Nonetheless, it is possible that in this particular case the debtors had not received appropriate information on the exchange rate risk before concluding the contract. This is something that they have to prove before the court.

Thus, two different legal instruments and two issues are mixed: on the one hand whether debtors receive adequate information on the exchange rate risk and the associated dangers prior to the conclusion of the contract. On the other hand, whether Paragraph 10 of the loan agreement and its provisions on exchange rate risks concluded with the debtors is intelligible and plain.

This raises a further question, namely if the oral and written form of communicating information to the consumer are treated in the same way. Typically, communication of information before concluding the contract is provided orally. By contrast, the plain and intelligible nature of the contractual clause can only be assessed on the basis of the written text. Failure to provide oral information prior to concluding the contract or the incomplete, inadequate nature of such oral information does not entail the invalidity of the contract as its legal consequence. In this event the consumer may bring action for damages against the other party who failed to honour its duty to communicate information. The transparency (plain and intelligible nature) of the contractual provision, however, can only be judged from the written documents produced in connection with the conclusion of the contract. Therefore whether the nature of a contractual provision is plain and intelligible can hardly be established from the oral information that had been given to the consumer before concluding the contract.

We believe that in this context the following statement of the summary prepared on the meeting of the Consultative Body of the Kúria of 10 April 2019 also needs clarification: *„If the upper limit of the expected exchange rate increase or its highest order of magnitude can be*

48 The consumer as the debtor of the loan agreement with the bank may request this explanation from the notary, too. The majority of these contracts are acknowledged by a notarial act in order to ensure immediate enforcement. By virtue of Subsection a) of Section 120(1) of 1991 on civil law notaries, the notary is obliged to inform the concerned party about the nature and consequences of the legal transaction.

inferred from the plain and intelligible written or oral information, the consumer is liable for the exchange rate risks only the degree defined therein". In fact, the lack of communication of plain and intelligible information preceding the conclusion of the contract is not a ground for invalidity, but a circumstance for bringing action for damages in favour of the consumer.

4. 2. Judgement in Case C-118/17

4.2.1. Facts of the Main Proceedings

On 24 May 2007, the debtor concluded a loan contract denominated in Swiss francs with a Hungarian bank. According to the terms of that contract, the loan should have been advanced in Hungarian forints by applying the CHF-HUF exchange rate based on the bank buying rate on that day. This resulted in a payment of HUF 14.734.000, the resulting amount of the loan in Swiss francs being CHF 115.573. The contract also provided that the loan repayments are to be made in Hungarian forints, the applicable exchange rate being however the selling rate practised by the bank. The judgment of the EJC highlighted that the exchange rate risk connected with fluctuations in the exchange rate of the currencies concerned was borne by the debtor.[49]

On 12 April 2016, at the request of the bank, the notary public ordered the enforcement of the contract.[50] The debtor filed an objection to the enforcement. She claimed that the contract was null and void on the ground that it did not specify, in accordance with Article 214 (1) (c) of the former Act on Credit Institutions, the difference between the exchange rate applicable when the funds were released and the exchange rate applicable when the loan was paid off, the so-called exchange rate margin.

The Hungarian referring court decided to stay the proceedings and to request a preliminary ruling from the European Court of Justice. The Hungarian court addressed altogether five questions to the European Court.

4.2.2. Judgment of the EJC

In its Judgment the ECJ states that the Hungarian legislature amended the foreign currency-based consumer loan contract by legislative means in such a way that the validity of the contracts was safeguarded. This is compatible with the objectives pursued by the EU legislature as set out in Directive 93/13 and in particular Article 6 (1) thereof. The objective consists in restoring the balance between the parties while in principle preserving the validity of the contract as a whole rather than in cancelling the entire contract. Thus, Article 6 (1) of the Directive seeks to restore the balance between the parties, and not to cancel the contract containing unfair terms.

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49 Such provision, however, was not likely to be included in the loan agreement. The conclusion that the risk associated with the exchange rate was borne by the debtor can rather be drawn from the contractual arrangement and other provisions of the contract.

50 In accordance with Hungarian law if the contract or a unilateral declaration of commitment is acknowledged by a notarial act, that commitment becomes immediately enforceable without litigation proceedings. In this case enforcement was ordered by the notary at the request of the of the party seeking enforcement, after which the enforcement proceedings are carried out by the competent bailiff.

A contract must continue in existence, in principle, without any amendment other than that resulting from the deletion of the unfair terms, in so far as, in accordance with the rules of domestic law, such continuity of the contract is legally possible. A contractual term held to be unfair must be regarded, in principle, as never having existed, so that it cannot have any effect on the consumer. Thereby it has the consequence of restoring the consumer to the legal and factual situation that he would have been in in the absence of that term.

Article 7 (1) of Directive 93/13/EEC does not preclude the Member States from using legislation to put an end to the use of unfair terms in contracts. The legislature of the Member State, however, must in that context respect the requirements deriving from Article 6 (1) of that Directive. The fact that certain contractual terms were, by means of legislation, declared to be unfair and void and replaced by new terms, in order to allow the continued existence of the contract at issue, cannot have the result of weakening the protection guaranteed to consumers.

Article 6 (1) of Directive 93/13/EEC does not preclude national legislation preventing the court seised of the case from granting an application for the cancellation of a loan contract on the basis of the unfair nature of a term. This, however, is only possible if finding that such a term is unfair allows the legal and factual situation that the consumer would have been in the absence of that unfair term to be restored.

The EJC then examined Section 37 (1) of the Settlement Act (Act XI of 2014). Pursuant to this subsection: *„In relation to contracts falling within the scope of this Law, the parties may apply to the court for a declaration of invalidity of the contract or of certain contractual terms ("partial invalidity") — irrespective of the grounds for such invalidity — only if they also request determination of the legal consequences of invalidity, namely a declaration of validity or effectiveness of the contract up to the time of adoption of the decision)[…]."* The referring Hungarian court contested the provision according to which in case of establishing the invalidity of the loan contract, as a further legal consequence the court should either declare the contract valid or effective up to the time of adoption of that decision.

With regard to the examined Hungarian provision the EJC found that the examined Hungarian provision implies that consumers, where they invoke the unfair nature of a term other than that relating to the exchange difference or that permitting the unilateral amendment of the contract, must also request the court seised of the case to declare the contract to be valid until the date of its decision. The ECJ held that the provision prevents, in breach of Article 6 (1) of Directive 93/13, consumers from being exempted from the unfair term concerned, where appropriate, by means of the cancellation of the contract at issue in its entirety if that contract cannot continue in existence without that term. In fact, it is apparent from the findings made by the referring court that the continuation of the contract would be contrary to the interests of the consumer.

Based on the above, the ECJ replied to the first three questions raised by the Hungarian referring court as follows:

a) Article 6 (1) of Directive 93/13/EEC does not preclude national legislation which prevents the court seised of the case from granting an application for the cancellation of a loan contract on the basis of the unfair nature of a term provided that a finding that terms in such an agreement were unfair would restore the legal and factual situation that the consumer would have been in, had that unfair term not existed,

b) Article 6 (1) precludes national legislation which prevents, in circumstances such as those at issue in the main proceedings, the court seised of the case from granting an application for the cancellation of a provision of the loan contract relating to exchange rate risks on the basis of its unfair nature (where the referring court finds that the term is unfair and that the contract cannot continue to exist without the term).

4.2.3. Implications for Hungarian Law

The judgment handed down in Case C-118/17 was based on an essential doctrinal misunderstanding with regard to Hungarian law. In accordance with Recital 53 of the judgment, that the declaration by the referring court of the validity of the contract until the decision prevents the consumer from enjoying exemption from the unfair contractual clause, if necessary, through the cancellation of the entire contract.

In Hungarian civil law until 15 March 2014 the legal consequences of the invalidity of contracts are set out in Subsections (1) and (2) of Section 237 of the Civil Code of 1959.[51] Pursuant to Subsection (1): *„With regard to invalid contracts, the state of affairs having existed prior to the conclusion of the contract shall be restored.” And Subsection (2) sets out that: „If the state of affairs having existed prior to the conclusion of the contract cannot be restored, the court shall declare the contract valid for the period up to the date of judgment. An invalid contract may be declared valid if the cause of invalidity can be abolished, in particular by eliminating the disproportionate advantage in the case of a usurious contract or the unreasonable disproportion between the services of the parties. In such cases, it shall be necessary to provide for the return of any services that might remain without consideration.”*

In accordance with the Civil Code of 1959 therefore the court may apply the following legal consequences in case of establishing invalidity:

- restoring the original state of affairs (in integrum restitutio);
- declaring the contract to be valid;
- declaring the contract to be in force.

Hungarian judicial practice primarily seeks to save the contract that is to declare it to be valid. The declaration of an invalid contract to be valid is one of the typical cases of judicial contract amendment during which the court amends the original content of the contract. The contract continues to remain in force with the content amended by the court.

If however the declaration of the validity of the contract cannot take place for any reason, the court attempts to restore the original condition preceding the conclusion of the contract. In case this is impossible (e.g. contracts on so-called irreversible services), the court creates a special settlement relationship between the parties. This is the declaration of the invalid

51 On 15 March 2014 Act V of 2013 on the Civil Code entered in force. In the main proceedings before the ECJ, however, the Civil Code of 1959 is applicable. It is worth noting that the new Civil Code ceased to include declaration of the contract to be in force until the decision in the legal consequences of invalidity. Instead, Section 6:113 of the Civil Code is on payment for monetary value for unjust enrichment.

contract to be in force provided by the Civil Code of 1959. In this event provision should be made of the return of the service without remuneration or the refunding of performed services.

The objective of declaring the contract valid in the case of contracts of pecuniary interest is to make sure that compensation for the performed services is granted. The compensation is not necessarily equivalent to the compensation defined by the parties in the invalid contract. Moreover, if the legal relationship had already ceased between the parties, the contract does not need to be declared effective until the date when the decision is made. The limitation period, however, should be taken into account when declaring the contract effective.[52]

Under Hungarian civil law doctrine it was difficult to declare an invalid contract effective as the issue of effectivity could only arise in the case of valid contracts. Invalid contracts cannot be nor effective neither ineffective. In exceptional cases and in limited circumstances, the issue of the capability to produce legal effects may also arise with regard to ineffective transactions. This is because the establishment of invalidity occurs only years after the conclusion of the transaction, hence a transaction declared ineffective retrospectively may be capable to produce legal effects for a while. Nevertheless, the capability of invalid transaction to produce legal effects should be regarded as an exceptional legal phenomenon, which should be delimited from the effectiveness of valid transactions.

The Civil Code of 1959 was forced to recognize the capability of invalid contracts to produce legal effects among the legal consequences of invalidity. Civil law had to match realities. A contract could be declared valid exceptionally in the interest of equity, in order to ensure the principle of value for money of the services provided.[53]

Consequently, the related statement in the Judgement of the ECJ cannot be interpreted with respect to Hungarian law. In accordance with the judgement of the ECJ, EU law precludes national legislation which prevents, in circumstances such as those at issue in the main proceedings, the court seised of the case from granting an application for the cancellation of a provision of the loan contract (relating to exchange rate risks) where the referring court finds that the term is unfair. The ECJ deemed that the instrument of Hungarian civil law allowing validity to be declared prevents the consumer from not being bound by the unfair contractual term.

As shown above, however, in case an invalid contract is declared effective, the court grants an application for the cancellation of the loan contract. In cases of declaring effectiveness, the court first establishes the (full or partial) invalidity of the contract. It can then decide on the declaration of effectiveness, provided that this had been requested by the concerned party. If in contrast the party had not requested the application of the further legal consequences of invalidity, the court only establishes the invalidity of the contract. In this event separate proceedings have to be launched to establish further legal consequences.

The statement of the ECJ according to which the declaration of invalidity prevents the consumer from being not bound by the relevant unfair contractual term is also incorrect. Whatever the circumstances, the consumer is exempted from the unfair contractual term owing to the fact that invalid legal representations do not bind the parties. It is a different

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52 SÁNDOR, István: *A szerződés tartalma és tárgya.* In: OSZTOVITS András (szerk.): A Polgári Törvénykönyvről szóló 1959. évi IV. törvény magyarázata. I. kötet, Opten Kft., Budapest, 2011. pp. 696-697.

53 SÁNDOR: i.m. p. 697.

matter that performance, movement of assets could also occur on the basis of the invalid transaction. A loan contract is typically such a situation, as the creditor has disbursed the loan amount, and the debtor has started to pay the instalments. The resulting imbalance should be addressed in one way or another even if the court has established the invalidity of the contract. This however does not mean that the consumer is bound by the invalid contract, even less that the court could not declare the invalidity of the contract containing the unfair clause.

The statements of the ECJ therefore cannot be interpreted when applied to Hungarian law, since these rules are unknown to Hungarian civil law. Moreover, the judgement of the ECJ does not make mention of the provision that applies to loan contracts at issue in the main proceedings under Hungarian law. This rule is laid down by Section 37 (1) of the Settlement Act. Thus, in relation to loan contracts falling within the scope of the Settlement Act, if the court declares the full or partial invalidity of the contract, only two legal consequences may be applied: the court either declares the contract to be valid or declares it to be effective up to the time of the adoption of the decision. This provision actually confirms that in case invalidity is declared with regard to these loan contracts, the original condition cannot be restored.

The above follows from the legal nature of services covered by loan contracts. In fact, loan contracts contain an irreversible service as well: the debtor uses the creditor's money during the term of the loan, and such use cannot be undone even if invalidity has been declared. As a result, if the invalidity of the loan contract is declared, the original situation that existed prior to the conclusion of the contract cannot be restored. In the case of loan agreements, the concept of *in integrum restitutio* is excluded. This is underlined by the fact that once the loan amount has been disbursed, the parties cannot withdraw from the contract. They may only terminate it for the future unilaterally by termination.

For that matter, Section 37 (1) of the Settlement Act was examined by the ECJ in another judgement and found it to be in compliance with EU law. In its judgement in Case C-483/16 of 31 May 2018 the ECJ stated: Article 7 of Directive 93/13 should be understood not to preclude national legislation which lays down specific procedural requirement (such as those at issue in the main proceedings), for actions brought by consumers who concluded loan agreements denominated in foreign currency, containing a term concerning the difference in exchange rates and/or a term concerning the power of the creditor to make unilateral amendments on the increase of interests, charges and costs (provided that a finding that terms in such an agreement were unfair would restore the legal and factual situation that the consumer would have been in had those unfair terms not existed).

5. Summary

5. 1. Evaluation of Foreign Currency-based Loan Agreements as a Contractual Arrangement

In our view the most essential issue relating to the arrangement of foreign currency-based consumer loan contracts was that the parties transferred nearly all risks associated with the transaction to the weaker party, the consumer. Paragraph 10 of the consumer loan contract assessed in Case C-51/17 provided that: *„the debtor….is aware of the risk of taking out a foreign currency loan, a risk which he alone bears.”*

It is obvious that all transactions imply risks. The parties seek to mitigate their own risks and to transfer them to the other party. Civil law must react to this situation and in doing so, must take into account that the legislature itself seeks to distribute risks in a balanced way (as apparent in dispositive legal norms). Transferring risks associated with transactions therefore is one of the most crucial and most debated matter of civil law.

The fact that a contractual arrangement which transferred nearly all the risks arising from the transaction to one of the parties, the consumer, could develop and was applied extensively can be attributed to weaknesses of the Hungarian legal environment and legislation. Exchange rate risk stands out of all such risks. In this respect one of the views expressed in legal literature was that banks in fact did not transfer the exchange rate risk to the customers, as that risk by definition is always to be borne by the debtor.[54]

Our position is that in this case the principle of reasonable conduct, an important principle of Hungarian civil law should also have been considered. In accordance with Section 1:4 (1) of the Civil Code, unless otherwise provided by this act, in civil law any reference to what can be expected of or by a person, or in a particular situation, is a reference to what can reasonably be expected. The question is what could have been reasonably expected from the consumer with regard to the exchange rate risk. Would he have been expected to reckon with a currency depreciation of roughly 20-30% on the basis of the exchange rate fluctuations of the previous ten years? Would he have been expected to foresee previously unprecedented degrees of depreciation of the forint against the Swiss franc? If financial institutions and experts did not reckon with such a degree of depreciation, how could the consumer have predicted it? These questions will be answered by the courts in the pending proceedings the subject matter of which among others is the transfer of the entire exchange rate risk to the consumer.

An additional problem is that neither judicial practice nor legal theory has come to terms to date with the legal consequence of the full or partial invalidity of foreign currency-based loans. Although the matter was examined carefully and thoroughly by a group tasked with analysing legal practice that was set up by the Kúriai 2015, no convincing majority opinion has emerged.[55]

It is to be seen whether in the case of the invalidity of the foreign currency-based loan contract the condition prior to the conclusion of the contract can be restored (*in integrum restitutio*). A view expressed in legal literature denies this and rather considers the declaration of effectiveness pursuant to the Civil Code of 1959 as a viable option.[56] We agree with this position, but the exact meaning of declaring the contract effective as well as the settlement to be applied between the parties in such cases requires further clarification.

Uncertainty persists on the part of those who apply the law despite the fact that the legislature took an unequivocal position in Section 37 (1) of Act DH2 as to the potential legal consequences of the invalidity of consumer loan contracts. In this respect the Act only identifies the declaration

[54] GÁRDOS, István – NAGY, András: *A devizahitel jogi alapkérdései.* Hitelintézeti Szemle, 5/2013. p. 376.

[55] See the summary report on the applicability of the legal consequences of invalidity to loan contracts. Accesible in Hungarian online at: www.lb.hu/sites/default/files/joggyak/osszefoglalo_velemeny_i.pdf

[56] GÁRDOS, Péter: *A kölcsönszerződés érvénytelenségének jogkövetkezménye.* Jogtudományi Közlöny, 11/2014. pp. 509–510.

of the contract to be valid and the declaration of its effectiveness up to the time of the adoption of the decision. The legislature deems that based on this in the case of the full or partial invalidity of the consumer loan contract, the original condition cannot be restored. The correctness of this legislative position, however, continues to be challenged by those applying the law.

5. 2. Conclusions

The spread of foreign currency lending and the shift of balance that occurred in these contracts in the wake of the 2008 crisis produced the most burning social issue in Hungary since the political changeover. Since it already threatened economic growth, the legislature had to address it. The acts passed in 2014 were devised to free Hungarian society from the difficulties caused by foreign currency loans definitively.

By now however it has become clear that for certain social groups neither settlement nor conversion into forints represented actual help. As a matter of fact, these debtors accumulated outstanding debts that well exceeded the value of the residential real estate offered as security; moreover they had experienced considerable delays in making payments even before the adoption of these acts. In their case the State had to come up with different solutions, among the measures of social policy. From a national economy perspective, a substantially simplified personal bankruptcy procedure would also be essential.[57]

It is to be hoped that both the Hungarian financial sector and those applying the law will draw the conclusions that would help to prevent similar situations in the future. This, however, requires the dissemination of financial literacy in the country, responsible lending as well as well-based decisions on borrowing on the part of the debtors.

The above is necessary since the key issue is not whether a crisis similar to that of 2008 can occur again. It is rather when it will occur. A recently published study on the specificities of Hungarian financial cycles stated clearly: the financial sector regularly experiences periods of expansion, which are accompanied by rising leverage, increasing risk-taking behaviour and looser lending standards. Periods of expansion are followed by contractions that can occur in the form of financial crises when financial institutions rapidly de-leverage, which results in a collapse of the credit supply.[58]

It would therefore be important for both Hungarian society and legislation to be better prepared for the next recession and handle its consequences more efficiently. Each economic downturn undoubtedly entails painful consequences and these cannot be addressed with legal instruments alone. The legal environment and legal practice have a role to play in mitigating the effects of a next crisis. To mention just one example: competent bodies should be less hesitant in exploiting the potential of launching actions in the public interest.

As far as the level of consumer protection in the financial sector is concerned, legislation in force in Hungary does not really differ from Western European standards owing to the adoption of new laws in 2014 as well as to the amendment of the Fair Banking Act. The potential therein however should be exploited not only be consumers, but also state authorities charged with the protection of consumer interests.

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[57] In Hungarian law Act CV of 2014 on the debt settlement of natural persons introduced reorganisation (personal bankruptcy) for private individuals facing payment difficulties.

[58] ROTS, Eyno: *Üzleti, lakáspiaci és hitelciklusok – Magyarország esete*. Hitelintézeti Szemle, 4/2018. p. 6.

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THE CONDITIONS FOR THE EMERGENCE OF FOREIGN CURRENCY LENDING – CAUSES AND EFFECTS[1]

[1] *This study contains the views of the authors and does not necessarily reflect the official position of the MNB.*

In this study we provide a historical overview about the process of domestic households' indebtedness observed in the 2000s, which meant the spread of foreign currency denominated loans from 2004. The first credit cycle following the democratic transformation commenced around the turn of the millennium, and the credit volume of households grew nine-fold in eight years in proportion to GDP. We demonstrate that the spread of this credit type was equally supported by demand and supply side factors: on one hand, the interest rate difference, the termination of interest rate subsidies and the previously relatively stable CHF/HUF exchange rate; on the other hand, the shifting of bank competition from the corporate credit market to the retail segment, as well as the access of financial intermediaries to foreign currency funding. The role of the institutional environment is also essential in order to understand the process since the consumer protection regulation had not represented an obstacle to the mediation of the products that later became toxic. This phenomenon, along with a monetary policy reacting to the high inflation environment, balance of payment deficit due to low savings and loose fiscal policy, as well as high external debt put the economy in a vulnerable situation by the outbreak of the financial crisis in 2008.

1. Introduction

From the establishment of a two-tier banking system in Hungary, the financial system did not have one single peaceful decade. During the 1990s, the transition from the structural heritage of socialism and the single-tier banking system caused tension, which eventually led to the consolidation of the sector. At the beginning of the 2000s, an already more stable financial system characterized the economy, which took an active role primarily in lending for the corporate sector, while lending for households was still marginal at the time.

The 2000s were all about the indebtedness of the household segment. In the first years of the decade, the generous support of the government fuelled household and especially housing lending. First foreign currency denominated (FX) loans appeared with the blow-out of the subsidies, which quickly spread, and dominated the entire credit stock of the household sector by 2008. This progress is interesting as no obvious responsibility can be identified: households, banks, and even the regulators could argue that participation in FX-lending seemed rational. Subsequently, it is clearly apparent that the emerging situation posed serious financial stability risks, however, the dominating narratives before the crisis had a much more supportive approach to the processes of the time.[2]

The consequences are well known: with the spread of FX-loans, financial vulnerability increased rapidly, therefore the financial crisis that had become more entrenched in 2008 found the macro-economy in an unstable state. This vulnerability led to extreme pressure to adapt: the economic stakeholders (households, corporations, credit institutions and even the Government) were obligated to deleverage, which accompanied the contraction of the real economy.

[2] Hungary is not a unique case in this respect. Most financial crises are preceded by euphoria (KINDLEBERGER – ALIBER, 2005), in which typically the economic stakeholders optimistically rate the processes and reject the parallelism that can be detected in the case of earlier crises – *"this time is different"*, as the title of the book by REINHART and ROGOFF (2011) aptly remarks.

Although the imbalances that formed before the crisis had an impact on numerous industries and sectors of the economy, we argue that household lending was the process that led to the most serious consequences. Beyond the direct financial effects, the social consequences were also serious, and despite multiple interventions by the Government, there were still over 100 thousand defaulted debtors in 2018.[3]

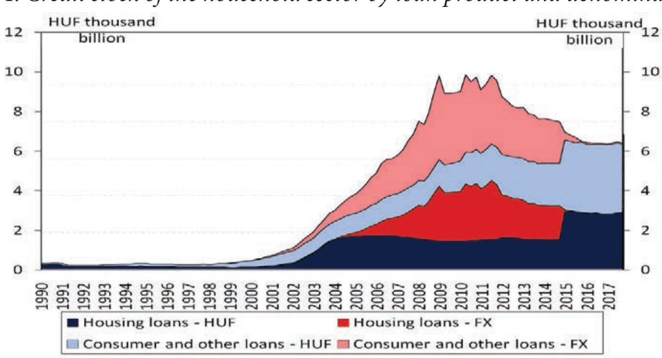
The aim of this study is to collect and synthetically present the causes already explicated in other texts. Such a summary is useful for two reasons. On one hand, most studies on FX-lending only concentrate on a particular segment of the inducing causes, so a synthesis and contextual analysis of these causes might be helpful. On the other hand, if more studies demonstrate the serious consequences of FX-lending, it may serve to remind future financial experts that indebtedness in a foreign currency is a "sin"[4] the consequences of which may be damaging for an economy for many years after.

2. What happened?

The indebtedness of households in Hungary started 10 years after the political transition.[5] In 2000, the credit-to-GDP of the sector was only 4 per cent, and in fact all disbursed loans were denominated in HUF and borrowed from credit institutions. Only about one quarter of these were mortgages taken out for housing purposes. However, not much later, in the mid-2000s a rapid growth of outstanding loans was observed, and there were substantial changes in the denomination structure (Fig. 1).

It can be noted about the credit stock that while it was some HUF 500 billion at the turn of the millennium, it increased by nearly HUF 1 thousand billion annually between 2003 and the outbreak of the crisis. Growth was faster in consumer loans than in the case of housing loans. During this period, consumer loans were mostly secured – this was the golden era of home equity loans. Due to the above, the credit volume of households increased to HUF 9.5 thousand billion, up to 35 per cent of GDP. In the meantime, the relative importance of various financial intermediaries also changed: while about 9 per cent of the credit volume could be linked to financial corporations in the early 2000s, this ratio was over 20 per cent from 2003 onwards.

Figure 1: Credit stock of the household sector by loan product and denomination



Source: MNB (Central Bank of Hungary)

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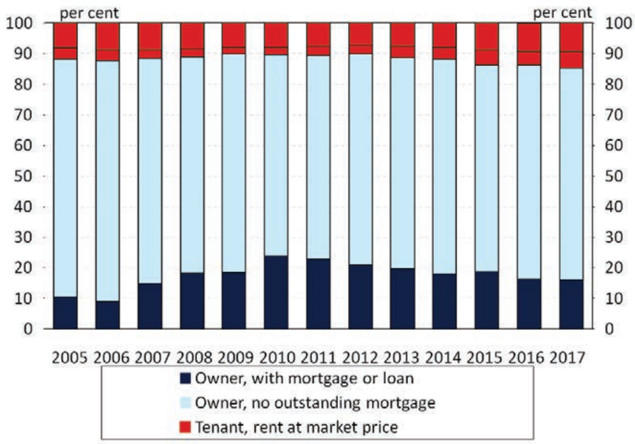
3 MNB 2018a.

4 EICHENGREEN et al. (2007) go so far as to call indebtedness in foreign currency "original sin".

5 Regarding the circumstances, see Chapter 3.

It must be noted when examining the growth of housing loans that traditionally a large proportion of the Hungarian population – 85 per cent to 90 per cent – are homeowners (Fig. 2). This attitude is similar in other post-socialist countries.[6] Based on a survey by Eurostat, one-tenth of the population lived in a home for which they were repaying a mortgage in 2005 – this ratio was 18 per cent in 2008 and peaked at 24 per cent by 2010. The increase in credit penetration is confirmed by other micro-level surveys: based on the questionnaire-based survey research of the Tárki Household Monitor the share of households with mortgages increased from 9 per cent in 2003 to 15 per cent by 2017.[7] According to their surveys conducted every two years, in 2001 nearly one-fifth of households had some kind of bank loan product, and by 2009, 35 per cent already had this type of debt.

Figure 2: Distribution of domestic households by tenure status



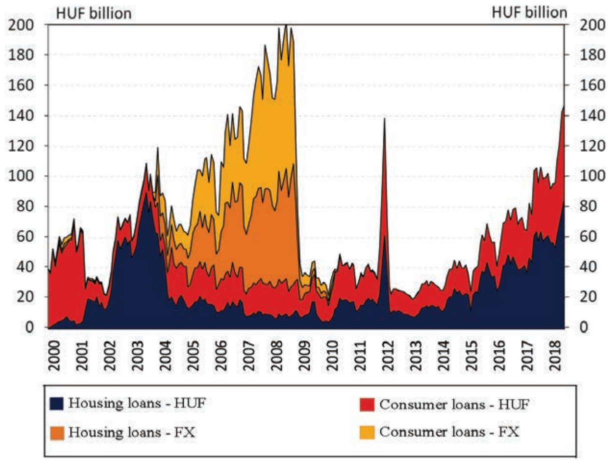
Source: Eurostat

From 2004 on, an increasing proportion of FX-denominated products appeared among the borrowed loans. Before that, their role was marginal, and mainly represented financing in EUR. However, from 2004, initially EUR loans, then CHF loans took over the leading role in the disbursements (Fig. 3). While in 2003 FX-loans represented a monthly 0.2 to 0.7 per cent of new housing loans, this increased sharply from 2004 and was 34 per cent in 2004, 63 per cent in 2005, 75 per cent in 2006 and 85 per cent in 2007. Consumer loans started from a higher level, but during certain months in 2007 80 per cent of new disbursements were already denominated in FX.

6 KOLOSI and FÁBIÁN, 2016.

7 MEDGYESI, 2016.

Figure 3: Monthly volume of new loans in the household sector



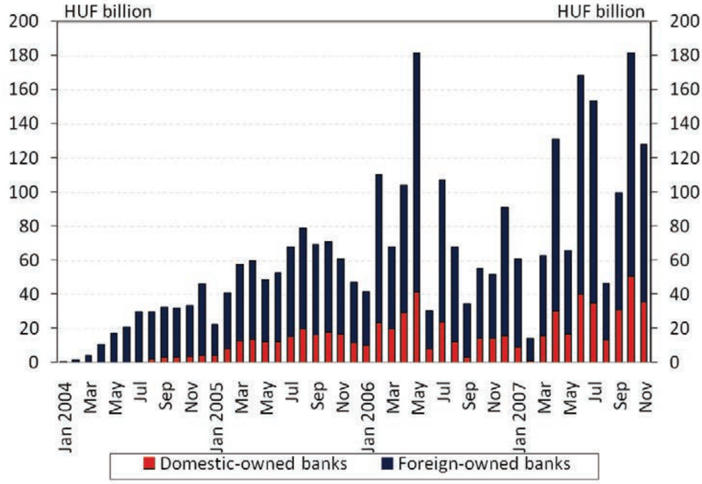
Source: MNB

As the first credit cycle progressed, clients who represented an increasingly higher credit risk were given loans from financial institutions. The growing risks can be detected in the development of the loan-to-value ratios of debtors, the extended maturities and the increasing contract sizes, and it is also confirmed by the narration of banks (see the MNB's Lending survey).

So directly before the crisis, the debtors' riskier status was accompanied by the spread of loan products comprising (interest rate and) exchange rate risk.

CHF-denominated household loans first appeared in the product range of foreign-owned banks, however, due to their popularity domestic-owned banks also soon – with a delay of about six months – took over this "innovation" to keep and increase their market share (Fig. 4). An increasing number of banks joined the disbursement until the outbreak of the crisis: while in early 2005 three quarters of FX housing loans were linked to four large banks, this concentration ratio started to decline in 2006. By the end of 2007, 10 banks had a market share over 1 per cent, and the share of the four largest institutions dropped to two-thirds. Since many institutions were involved in the spread of FX loan products, the volume of non-performing loans that quickly climbed to a high level with the outbreak of the crisis forced almost all the participants in the banking system to book major losses.

Figure 4: Monthly fluctuation of household CHF credit volume of domestic banks and foreign branches



Source: MNB

3. Why did it happen?

For FX-denominated lending to spread among households, three participants need to show willingness. On one hand, it is important that households prioritize FX-denominated products against loans denominated in the domestic currency. On the other hand, it is essential that the credit institutions are available in the given foreign currency, for which primarily their easy access to these resources is required. Finally, it is also a necessary condition that the regulatory institutions do not introduce measures which would prevent the spread of FX-lending. Overall, demand, supply and the institutional conditions of the establishment of FX-lending are distinguishable.

3.1. Demand conditions: the micro-level motivations of households[8]

The studies investigating the establishment of FX-lending based on aggregated data regularly examine the impact of a few macro-economic variables in the share of FX-loans. Among these macro-economic variables, one can most often find the difference in interest rates on domestic and foreign funds and the level and volatility of inflation and the real exchange rate.[9]

However, the findings produced by varied research are ambiguous. *Basso et al.* (2011) found that the relative volatility of inflation and the real exchange rate play a role, whereas Neanidis and *Savva* (2009), and *Neanidis* (2010) found these variables insignificant. The results in respect to the interest rate differentials are also diverse: *Rosenberg* and *Tirpák* (2008), *Csajbók et al.* (2010), and *Neanidis* (2010) identify this impact, while according to *Basso et al.* (2011), and

8 In the presentation of the international literature we greatly rely on a study by BECKMANN and STIX (2015).

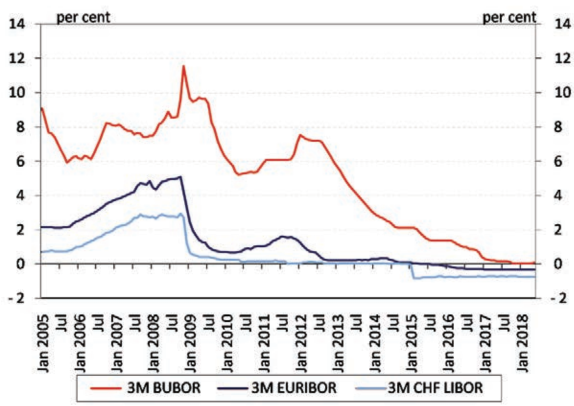
9 BECKMANN – STIX, 2015.

Luca and *Petrova* (2008) their extent is marginal. In addition to the above, the share of foreign banks[10] and the "dollarization" on the deposit side[11] may also induce the spread of FX-loans.

Instead of examining the impact of macro-economic variables on each other, other studies use questionnaire-based surveys. The advantage of this research method is that it is easier to separate the impacts of supply and demand, as macro-economic variables may effect both. In their research focusing on Central-Europe, *Firdmuc et al.* (2013) found that it contributes to the spread of FX-lending if households have little trust in the stability of the domestic currency and financial institutions, and progress is further strengthened if they are anticipating the introduction of the euro in the foreseeable future. By examining Austrian households, *Beer et al.* (2010) found that the households borrowing FX-loans are usually less risk-avoiding, with such people being older, wealthier, and with a greater degree of financial awareness than on average. By examining Hungarian households however, *Pellényi* and *Bilek* (2009) observed that those borrowing FX-loans do not have deeper financial knowledge, are not well off, and do not prefer risks more than those borrowing HUF loans.

By taking a closer look at the Hungarian situation, the interest rate disadvantage of the forint was obvious compared to foreign currencies, especially in respect to the Swiss interbank interest rate. In 2005, the average level of interbank HUF interest rates exceeded 7 per cent, while the average of the 3-month CHF LIBOR did not even reach 1 per cent during the same period (Fig. 5). The interest rate differential was about 630 basis points on average that year, which was only moderated to 550 and 520 basis points in the following two years. Consequently, while at the beginning of the decade the typical 6 per cent HUF interest rates of the period of generous government subsidies were competitive against FX interest rates, FX-loans might have seemed more attractive to households after the termination of these subsidies.

Figure 5: The development of the 3-month interbank yields of HUF, EUR and CHF



Source: European Central Bank, Swiss National Bank, MNB

[10] BASSO et al., 2011.

[11] LUCA – PETROVA, 2008.

The importance of the interest rate differential can be easily understand if we look at the average parameters of loans denominated in various currencies (Table 1). At the end of 2005, the price of an average 65-square metre dwelling was HUF 11 million, which meant a nearly HUF 7.8 million contract size with a 70 per cent loan-to-value ratio (LTV). If this amount of credit was borrowed in HUF, it was accompanied by a HUF 87 thousand monthly instalment rate with the average interest rate levels of that time (assuming a 15-year maturity), which used up nearly half of the income of a household with two average wages. In contrast, by borrowing a loan denominated in CHF the amount of the monthly instalment rate was HUF 65 thousand, which was only about 36 per cent of the household's income. From another perspective: those who were indebted in HUF were able to take a substantially smaller credit amount with a safer, 30 per cent payment-to-income ratio than those in a foreign currency. This means that liquidity-constrained households (with less savings) were more likely to choose FX-loans to satisfy their credit demand.

Table 1: Characteristics of a housing loan disbursed in December 2005 in different denominations

	HUF loan	*EUR loan*	*CHF loan*
Reference rate (%)	6.30	2.47	1.01
Average APR (%)	10.78	6.23	5.93
Instalment (HUF)	87,070	66,411	65,141
PTI (%)	47.7	36.4	35.7
Maximum contract size, PTI=30%, maturity=240 months	5,382,418	7,502,062	7,686,278

Note: Calculations are based on the average price of a 65 square metre dwelling at the end of 2005 with 70 per cent LTV-ratio and a 15-year maturity. We assumed a household with two average wages for the calculation of the payment-to-income ratio, where both wages correspond to the national net average.
Source: Own calculations, based on MNB

Of course, the interest rate differential benefiting the FX-loans does not guarantee by itself that the total financing costs of these loans will be actually lower[12] during the entire maturity than that of HUF loans. Namely, the depreciation of the forint can easily cut back on the benefit that the borrower takes with the lower interest rate.[13] With this in mind, a well-prepared borrower not only needs to examine the interest rates, but also the exchange rate fluctuations.

However, the HUF/CHF exchange rate was reasonably stable during the years of FX-lending (Fig. 6). The exchange rate was in the range of HUF/CHF 141 to 180 between August 2005 and August 2008. Overall, the fluctuation between the strongest and weakest exchange rate seemed affordable in respect to debt service: during 2005, the difference between the strongest and weakest status was barely 7 per cent, in 2006 it was 15 per cent, in 2007 it was 9 per cent, and in 2008 it was already 20 per cent. So, even if households considered the exchange rate fluctuations of the last few years when deciding on the currency of the credit to take, they might have come to the conclusion that even in the event of a relatively substantial exchange rate depreciation they would pay a lower instalment than if they took the credit in HUF. The expectations regarding

12 Here, total financing costs do not denote the legal term of the annual percentage rate of charge (APR), since this rate inter alia contains neither the "expenses" of the exchange rate fluctuation, nor that of the change in interest rates. See BERLINGER, 2017.

13 KIRÁLY – SIMONOVITS, 2015.

a stable exchange rate were also reinforced by the EU accession, which might have encouraged households to anticipate the introduction of the euro. This would have eliminated the exchange rate fluctuation against the euro within a reasonable time from the borrowing of the credit.

Figure 6: Development of the HUF/CHF exchange rate

Source: MNB

The indebtedness of the households had already commenced before the spread of FX-lending at the beginning of the 2000s, mostly due to generous government subsidies. Two new subsidies were introduced in 2000, the complementary interest rate subsidy and the mortgage interest rate subsidy, which became the most significant form of subsidy within a few years, thanks to their low costs (Table 2). The interest rate subsidies enabled the average interest rate level of mortgages to fall well under the market interest rate level, therefore borrowing became possible for a wide range of society. Following the introduction, several further easing measures were introduced related to the rules of utilization, and in addition the amount of the subsidy was raised, until the Government was forced to reduce its volume in 2002 due to the budget effect. The magnitude of the programme can be well presented by the fact that, at its peak, the subsidy for a HUF 10 million mortgage could reach up to HUF 7.47 million at the present value (Table 3).[14]

Table 2: Estimated volume of housing subsidy expenditures (HUF billion)

	1998	1999	2000	2001	2002	2003	2004	2005
Housing construction allowance	20.4	19.9	24	19.5	18.9	30.1	35.9	40.7
VAT refund allowance	0.2	1.9	5	5.9	6.4	9	9.7	6
Complementary interest rate subsidy	0	0	1.3	4.8	15	23.5	37.3	46.1
Mortgage interest rate subsidy	0	0	0.6	0.8	6.7	56.3	97.3	105.7
Housing savings' support	3	4.5	5.1	6.5	5.7	5.9	8.3	10.7
Debt service allowance	8	7.2	6	5.4	4.1	1.1	0.7	0.5
Personal income tax allowance	1.2	1.6	2.2	5.6	17	31.1	21.9	25
Total	**32.9**	**35.1**	**44.3**	**48.3**	**73.8**	**156.9**	**211**	**234.8**

Source: Hegedűs et al. (2006)

[14] HORVÁTH, 2008.

Table 3: Discount from the subsidies and its value compared to the house price

	Mortgage interest rate subsidy (HUF M)	Complementary interest rate subsidy (HUF M)	Personal income tax allowance (HUF M)	**Total (HUF M)**	Allowance in the case of a 20 HUF M dwelling
Before 2000	0.45	0	0.23	**0.68**	3%
2000	1.12	1.34	0.23	**2.69**	13%
Feb 2001	2.28	1.35	1.6	**5.23**	26%
Aug 2001	3.05	1.35	1.6	**5.99**	30%
Nov 2001	3.55	2.32	1.6	**7.47**	37%
Mar 2002	3.11	1.77	1.65	**6.54**	33%
Jun 2003	1.96	1.59	0.34	**4.38**	22%
Dec 2003	1.8	0	0.84	**2.64**	13%

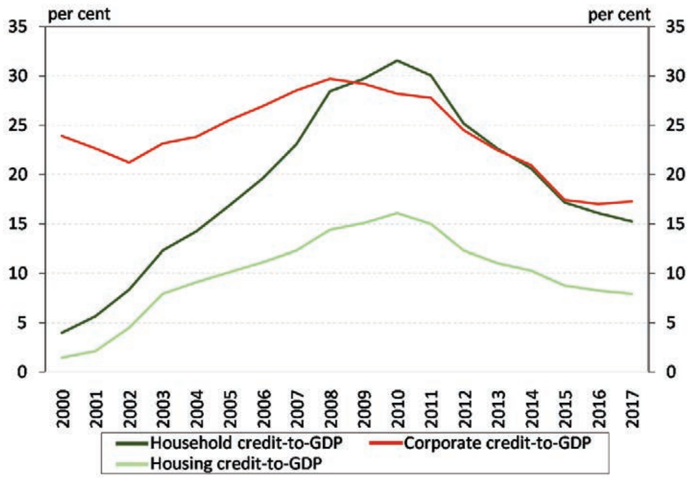
Source: Horváth (2008), page 83

3.2. Motivations on the supply side

After the establishment of the two-tier banking system, banks were primarily engaged in lending for the corporate sector. This was partly evident since in many cases both borrower companies and lender banks were under foreign ownership, and potentially a business relationship between the parent companies already existed. In contrast, on the household credit market there was considerably less information about the debtors, therefore the informational asymmetry between the banks and the households was more substantial. This was also noticeable in the structure of the credit market's deepening: while in 2000 corporate credit-to-GDP reached nearly 25 per cent, the size of household credit market was under 5 per cent of GDP (Fig. 7).

At the same time, a deeper corporate credit market also meant that this market was a lot more saturated by the beginning of the 2000s, accordingly it was also characterised by fiercer competition, so the available interest rate spreads were also significantly lower. This saturation steered the banks towards the household segment, for which the increasing government subsidies in the beginning of the 2000s provided proper timing. The government subsidies increased the share of households which could appear as solvent demand on the credit market. Consequently, the deepening of the household lending market commenced as well: until 2005, the outstanding loans nearly tripled in proportion to GDP.

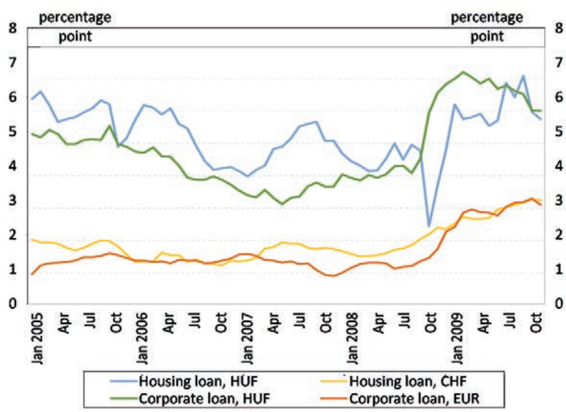
Figure 7: Household and corporate credit-to-GDP



Source: MNB

As pointed out in the previous chapter, after the reduction of government subsidies only FX interest rates were able to guarantee that price level by which the solvent demand on the household credit market kept growing. CHF-loans provided materially high interest rate spreads for banks, therefore they could earn substantially higher levels of profit on these loans than on corporate lending (Fig. 8). If in addition to the funding costs, we also consider other expenses in the calculation of the profit surcharge (based on the estimated results of the Lerner indices), it can be observed that household lending provided a higher margin for the banks.[15]

Figure 8: Interest rate spread in housing and corporate loans over the 3-month interbank rate



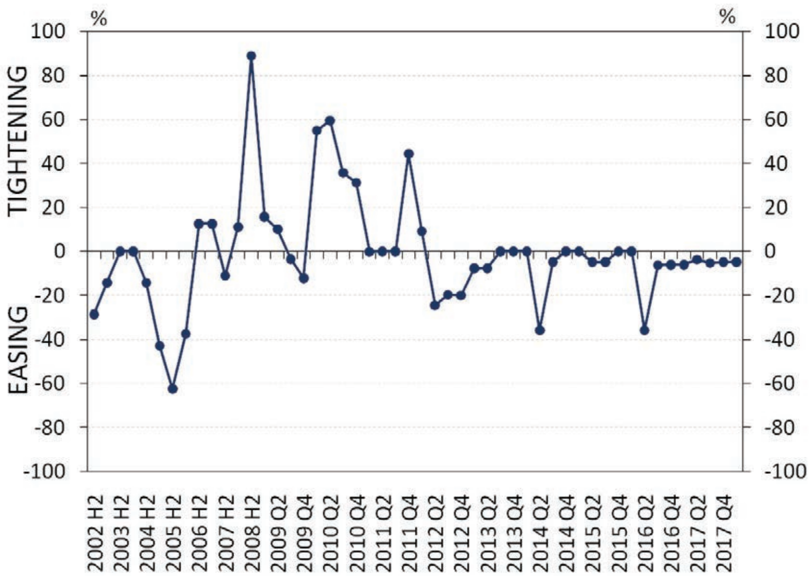
Note: CHF loans in the corporate segment and EUR loans in the household segment were insignificant.

Source: MNB

[15] HOSSZÚ – DANCSIK, 2018.

In parallel with the growing disbursements of FX-loans, however, this market also became more saturated. This meant that in order to increase their market share, certain banks were obligated to ease lending standards and reduce prices. The latter development also appeared in the decreasing Lerner-index between 2005 and 2007. On one hand, the semi-annual MNB Lending survey proves the easing of credit conditions: for several semesters from 2005 more than one-third of the banks eased housing lending standards (Figure 9: 9). The same is proved by the distribution of disbursed housing loans by loan-to-value ratio: in 2008, nearly 70 per cent of the disbursed loans had an LTV ratio over 70 per cent (Fig.10).[16] The role of credit agents also boomed during this period, which also contributed to the increasing volume of FX-loans and on average meant lending to clients with a significantly lower credit rating. Overall, it can be stated that risk competition was established between banks during this period.[17]

Figure 9: Changes in credit conditions in the housing loan segment



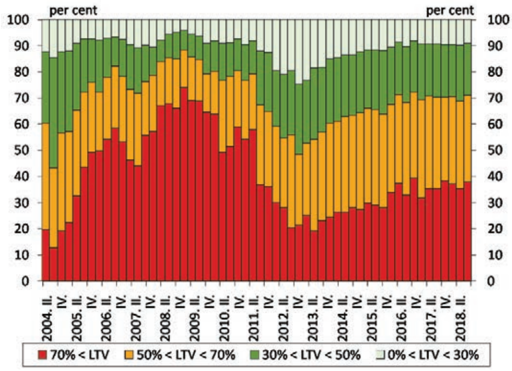
Note: The difference between tightening and easing banks (compared to the previous quarter) weighted by market share.

Source: MNB, based on banks' responses.

[16] No data is available on the distribution of payment-to-income ratio, but based on surveys we can estimate the average level of PTI ratio at between 30 per cent and 40 per cent (BALÁS et al., 2015). As a comparison: in 2017, the majority of the HUF loans – without exchange rate risk – were disbursed with a 20 per cent to 30 per cent PTI ratio.

[17] KIRÁLY – NAGY, 2008. This was also confirmed by bank experts making statements about FX-lending. In addition to the risk competition, they also pointed out the bandwagon effect as the distortions of the volume-based incentives system (see HVG, 2011).

Figure 10: Distribution of new housing loans by LTV

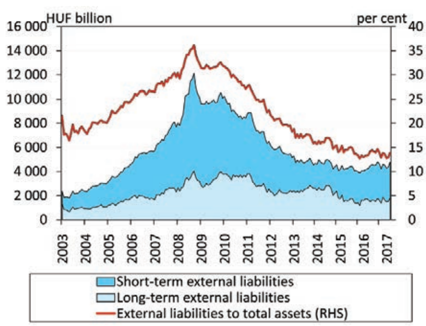


Source: MNB

To disburse FX-loans banks needed foreign currency on the liability side too – in order to close their open position. They typically created that in two ways: by raising foreign currency funds directly, in many cases from the parent banks with short duration, on the balance sheet (Fig.11, Fig. 12), or by creating it synthetically, often off a balance sheet with short-term FX-swaps (Figure 14:).

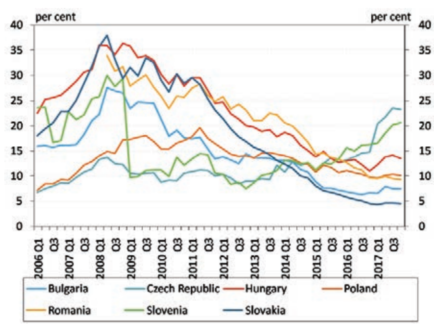
The loan-to-deposit ratio of the sector was also reflected in the financing structure, the value of which was well over 100, indicating (Figure 13:) that the financing of the credit expansion was not carried out by involving relatively stable deposits but by more volatile resources. By increasing foreign currency funds banks were able to facilitate the sector not having an exchange rate risk in the balance sheet, therefore the HUF/CHF exchange rate fluctuations' direct impact on profits was marginal. However, in parallel with the spread of FX-lending, the sector was increasingly relying on renewing foreign, short-term FX-funds, [18]the prerequisite of which was to have a permanent global abundance of liquidity, and to avoid tensions in the given financial markets.

Figure 11: The volume of external liabilities and their proportion to total assets in the Hungarian banking sector



Source: MNB

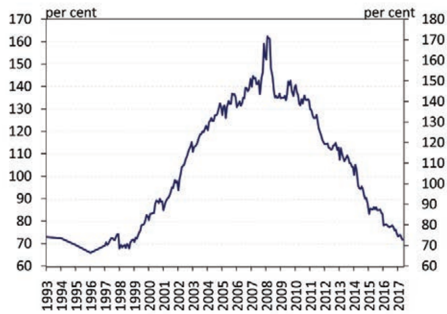
Figure 12: External liabilities to total assets in an international comparison



Source: ECB

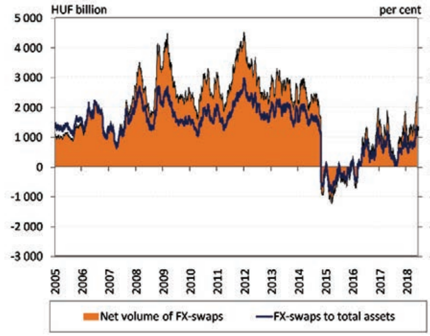
[18] KOVÁCS, 2009.

Figure 13: Loan-to-deposit ratio in in the Hungarian banking sector



Source: MNB

Figure 14: The volume of foreign currency swaps and their proportion to total assets the Hungarian banking system



Source: MNB

During the mid-2000s however, there was no sign of these tensions. This period was the period of global liquidity abundance, during which one could access funds remarkably easily – in many cases through the mediation of foreign parent banks. The low CDS spreads (typically under 50 basis points) and the low spreads were indicating tension-free access to the funds. Therefore, domestic banks could easily obtain foreign currency funds required for FX-lending.

4. Institutional frictions

Following the supply and demand factors of FX-lending it is also important to discuss its institutional environment. Among these, in relation to exchange rate policy prominent significance is assigned to the central bank and its objective, as well as the strategy set out to reach the objective, and, in connection with that, the relation of the central bank to the level and volatility of the exchange rate. Consumer protection rules also have an important role, which might limit and steer the lending activity of banks to an appropriate channel. In respect to FX-lending, available alternatives also have an important role, e.g. whether it is possible to take out a loan with long-term interest rate fixation in domestic currency. The latter cannot be decoupled from the funds available to the banks: loans with long-term interest rate fixation can be sustainable for the financial system if their interest rate risk can be managed with proper financing (e.g. mortgage bond issuance or securitization).

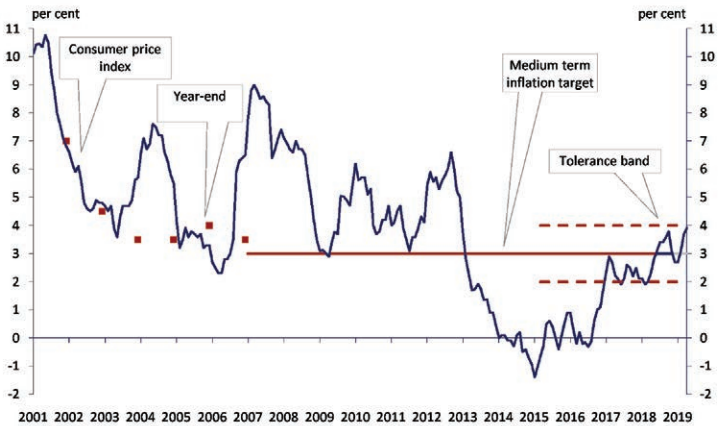
4.1. The role of monetary policy

Since the summer of 2001, the central bank has pursued its monetary policy in an inflation targeting system. This means that during the operation the objective is to achieve the pre-announced inflation target, then to maintain the inflation at this level. Within this framework, the primary objective is to achieve the inflation target, and all other endeavours (such as the aspects of financial stability or the support of the Government's economic policy) can only be considered afterwards. The central bank has several instruments to affect inflation, out of which the most important is the modification of its base rate.

In the case of an open economy such as that of Hungary, the development of the exchange rate plays an important role in the evolution of inflation. The depreciation of the HUF exchange rate makes imported goods more expensive, while its appreciation, in contrast, makes them cheaper, having a lowering effect on inflation. Therefore, a monetary policy step (for example, the increase of the base rate) partly unfolds its effect through the exchange rate channel.[19] The expectations also have an important role: if economic decision-makers anticipate an increase in inflation, they might make decisions which can justify these expectations as self-fulfilling prophecies. Therefore, in reaching the inflation target the management of expectations plays a prominent role.

At the beginning of the 2000s, inflation was at a rather high level – and over the inflation target in several periods – in Hungary (Figure 15:). Inflation, of course, was not independent from the overspending fiscal policy that characterised this period. It can be stated in general that when the fiscal policy is conducting over-spending, it makes the disinflational endeavours of the central bank more difficult as the constant overshooting of the inflation target might damage the operations of the expectations channel and the credibility of the central bank. All the above means that a central bank would have to conduct a tighter monetary policy to achieve disinflation than if the fiscal policy was more prudent and the inflation expectations stayed close to the target.

Figure 15: Developments in the inflation and the inflation target after the introduction of inflation targeting



Source: MNB

According to certain opinions about the monetary policy, the MNB led an overly restrictive monetary policy during this period, i.e. the central bank base rate was higher than it should have been.[20] According to the argument the HUF base rate primarily has to “compensate” the investors for higher inflation and higher country risks, but the HUF base rate contained a higher premium than this compensation. This higher premium, according to the study, led to a “stronger-than-appropriate” HUF exchange rate, which also manifested in the consolidation

19 For the channels of monetary policy and the monetary policy of the MNB see VONNÁK, 2006 and MNB (2012).

20 ERDŐS, 2010, ERDŐS, 2011.

of the real exchange rate. *Bihari* and *Valentiny* (2010) contest this statement and point out that despite a "too strong" forint, the export performance of the economy continuously increased during these years. Furthermore, they also point out that the consolidation of the real exchange rate is quite usual in convergence countries similar to Hungary. They also stress that based on the legal regulation of the MNB, that it had no room for manoeuvre: the overshooting of the inflation target resulted in the restrictive monetary policy.

Based on the empirical results of *Csajbók et al.* (2010), the fact that the central bank had a "fear of floating" the exchange rate also contributed to the spread of foreign currency loans in Central and Eastern European countries. The relative stability of the exchange rate in this case could also contribute to households' underestimating the extent of the exchange rate risk. Ex post, it can be easily identified that the restrictive monetary policy of the MNB would have had less side effects if the FX-lending had been made more difficult through the use of other legal tools by the governmental decision-makers, as it was in other countries in the region.[21] A less expansive fiscal policy in the period under review would have also helped the efficiency of the inflation targeting.[22]

4.2. The legislative environment

In connection with the legislative environment, two factors are worthy of note: first, how supportive the effective legal regulation was towards FX-lending (how difficult it was to contract a foreign currency loan), and second, how adequate the disbursed loans were from in respect to consumer protection.

In respect to contracting FX-loans, the legal regulation did not impede the spread of these loans. Prior to the crisis, in contrast with several other countries in the region, there were no measures in Hungary that would have prevented the institution of FX-lending, except for the informative communication of certain institutions (primarily by the MNB) announcing the risks.[23]

The primary problem was that it was not clear: which institution among those in charge of financial stability and the banking system should deal with such fundamentally macro-prudential problems as foreign currency lending. Besides the uncertainty of the scope of responsibility, the tools allocated for the institutions were also not suitable for efficiently managing problems like this. The possible measures and responsible institutions are in Table 4.[24]

[21] BETHLENDI, 2011

[22] ERDŐS, 2007

[23] BETHLENDI, 2011

[24] An interesting additional factor is the behaviour of the Polish banking system, which also provided CHF-loans: certain Polish institutions visited the Polish financial supervisory board together in 2005 to request the prohibition of foreign currency lending. In the end, administrative prohibition did not take place; however, the supervisory board notified the banks in a recommendation in 2006 about higher risk awareness, more thorough information and to first try to offer clients zloty loans (the domestic currency of Poland) (MUCSI et al., 2015).

Table 4: Possible measures to restrain unhedged foreign currency lending and the responsible institutions

Administrative measures	Prohibition of loans unhedged from the aspect of exchange rate risk Sector-level limits or limits differentiated by banks for the ratio of unhedged loans or for its growth rate	MoF-HFSA
Prudential regulation	Establishment of a category similar to the country risk provision (to be deducted from the capital) for unhedged foreign currency lending Limitation of foreign exchange maturity transformation and of relying on too short liability Determination of limits for bank open position (on balance sheet, total), position limitation Tighter loan classification and provisioning rules for foreign currency loans Higher and differentiated capital requirements Stricter non-price minimum loan conditions (e.g. loan-to-value ratio limit)	MoF-HFSA
Supervisory measures	Increased risk-management requirements for foreign currency lending Closer supervision (more frequent off/onsite inspections) of banks with dynamic foreign currency lending or banks in a weak financial position. More stringent control of their relationship with financial enterprises. More intense communication of risks.	HFSA-MoF
Financial culture improvement and	Strengthening of the retail sector's financial culture and of consumer protection "Moral suasion" of the credit institutions	HFSA, MNB, MoF
Fiscal measures	Withdrawal of various government subsidies related to lending in case of unhedged foreign currency lending Taxation on unhedged foreign currency lending activity	MoF, Government
Monetary policy steps	Higher minimum reserve requirements on banks' foreign currency liabilities, lower interest paid on reserves	MNB

Note: HFSA: Hungarian Financial Supervisory Authority, MoF: Ministry of Finance.
Source: MNB (2006)

The most important preventive measure, however, would have been the reduction of the budget deficit: its inflation moderating effect would have enabled the reduction of the base rate. On one hand, this would have made FX-loans less attractive by reducing the interest rate differential. On the other hand, it would have increased their financing costs with the relative depreciation of the exchange rate. All this draws attention to the fact that the measures of the major economic policy institutions generating contradicting impacts (fiscal alcoholism versus inflation targeting) might have resulted in severe imbalances in the economy.

At the same time, we must add that the administrative limitation of FX-loans would not have been free of every legal difficulty: one of the four freedoms of the European Union is the free movement of capital, and the prohibition of foreign currency lending would not have met this.[25]

In addition to the occurrence of foreign currency lending, the consumer protective insufficiencies of the contracts also caused problems. It became obvious after the outbreak of the crisis that the vast majority of the contracts provided a dominant position in unilateral pricing for the bank, i.e. the latter could have shifted relatively easily its losses to the debtors of existing loans. This means that banks did not apply a *through the cycle price* during the years of FX-lending, but a lower one, knowing that in the event of any external shock it would be able to raise the interest rates *ex post*. This was later confirmed: following the

[25] This is well reflected by the fact that when the FX-lending was actually prohibited in 2010, the European Central Bank objected to this measure, due to which it had to be modified. Currently, the borrowing of foreign currency loans is allowed, however, only for borrowers who meet very strict conditions (which are impossible for most debtors).

outbreak of the crisis banks raised the interest rate of existing FX-mortgages by an average of 2 percentage points,[26] which – beside the depreciation of the HUF exchange rate – substantively contributed to the increasing monthly debt service.

Although the unilateral interest rate increases were paid back to the clients with the settlement in 2015, it would have been more reasonable if during the disbursal of FX-loans the legislative environment provided an unambiguous and transparent system of conditions for both parties for signing the contracts.

5. Consequences and outlook

In recent decades (and especially following the outbreak of the financial crisis), international literature has striven to define those processes which might imply an emerging financial crisis in the economy. Though each crisis is obviously different according to the unique characteristics of the economies, studies have still managed to identify a few trends that substantially increased the vulnerability of the economy and the probability of an emerging banking crisis.

These studies found that banking crises are most often preceded by excessive lending. Either from an historical aspect[27] or by statistical analysis[28] the common feature of periods prior to the banking crisis is a large amount of credit flowing out to the economy. This, often simultaneously with a reduction in saving willingness, can lead to a deteriorating balance of the current account, i.e. the economy depends more on foreign capital – and this capital is often only available with ever shorter periods of maturity.[29] The large-scale credit outflow often contributes to the increasing price of a real or financial asset, thus house price or stock market booms might develop.

The most widespread method for seizing the excessiveness of lending is the quantification of the credit-to-GDP gap. During the calculation of the indicator, the development of credit-to-GDP is decomposed to a trend and a cycle component, and if the actual value of the indicator exceeds the trend considerably and permanently, lending is considered excessive. The trend-cycle decomposition can be carried out by multiple methodologies but none of them are free from estimate uncertainties.[30] Based on the credit gap calculated for the domestic household outstanding loans the credit volume exceeded the estimated equilibrium level after 2005, and the credit gap reached its maximum peak by the turn of 2008 to 2009 (Figure 16:). This implies that lending dynamics were not coupled with income developments.

[26] The increases were certainly defensible in respect to economics by the increasing resource costs, country risk, state burdens and bank losses (SCHEPP – SZABÓ, 2015, SCHEPP – MÁTRAI-PITZ, 2016), however the possible changes of burdens derived from the contract were made non-transparent and untraceable for the consumer.

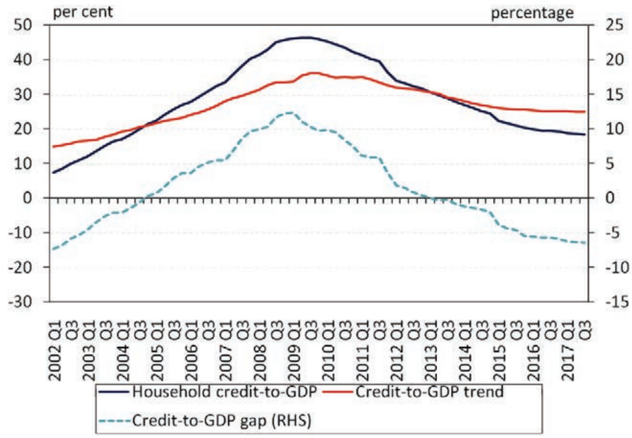
[27] KINDLEBERGER and ALIBER, 2005, and SHULARICK and TAYLOR, 2012

[28] BORIO – DREHMANN, 2009

[29] LÁMFALUSSY, 2008

[30] HOSSZÚ – KÖRMENDI – MÉRŐ, 2016

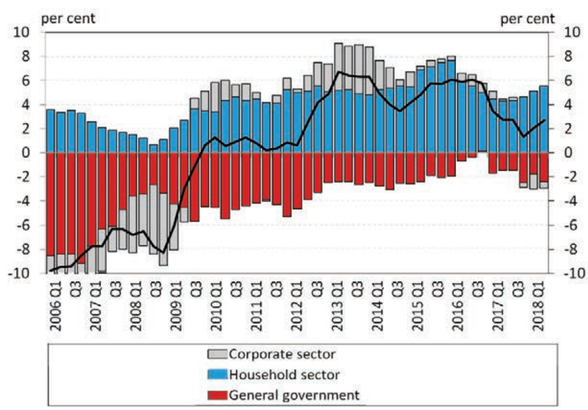
Figure 16: Household structural credit-to-GDP gap



Note: Based on Hosszú, Körmendi and Mérő (2016). Source: MNB

The development of the current account showed a large deficit before the outbreak of the crisis (Figure 17:). Its emergence can be largely linked to the budget deficit, the extent of which was not even approached by the continuously decreasing contribution of households to the balance. As the previous chapters showed, the substantive part of external funds involved to finance the deficit of the current account flowed into the economy via the banking system, and they mainly consisted of short-term funds. The two conditions of vulnerable financial systems – excessive lending and current account deficit – were both met in Hungary before the crisis.

Figure 17: Net lending of specific sectors (as a percentage of rolling annual GDP)

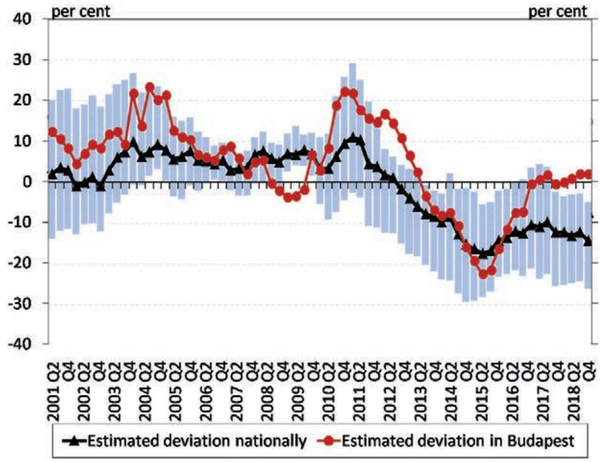


Source: MNB

The picture is not so obvious in the development of asset prices. Excessive lending did not fuel the housing market to the same degree as was typical in the case of real estate crises during previous banking crises. In the period of 2005 to 2008, models showed a slight overvaluation of house prices, moreover, the price level could be considered as equilibrium based on estimates (Figure 18:).

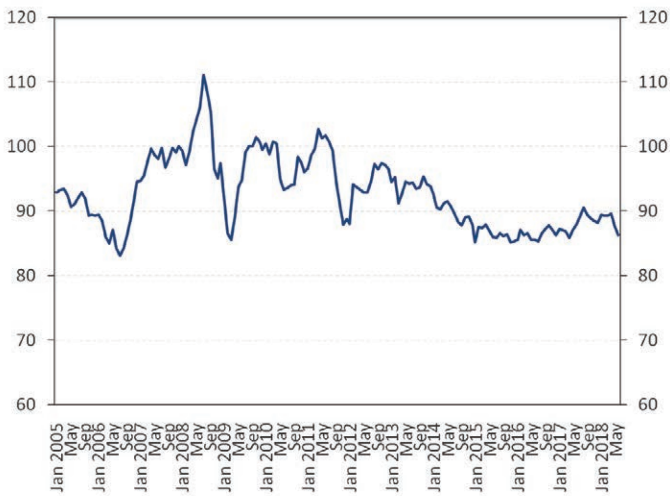
However, overvaluation could develop in the real exchange rate during the period of foreign currency lending (Figure 19:): between the summer of 2006 and 2008, the real exchange rate appreciated by some 21 per cent. The external funds and the disbursement of FX-loans both contributed to this exchange rate appreciation to a great extent.

Figure 18: Deviation of house prices from the estimated level justified by fundamentals, nationally and in Budapest



Note: Light bars denote the uncertainty of the national estimate. For methodology see MNB (2018b) footnote 4.
Source: MNB (2018b)

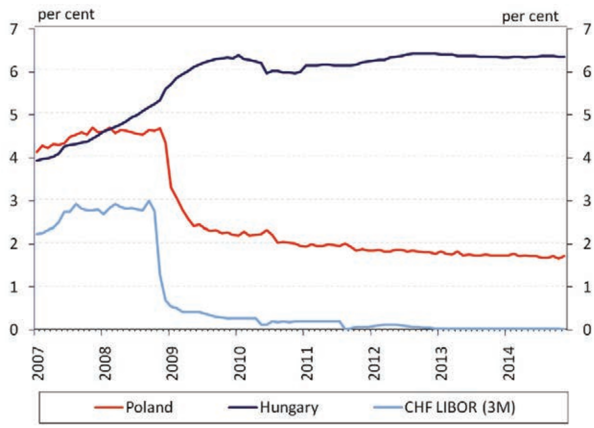
Figure 19: The development of the HUF real exchange rate (December 2007 = 100 per cent)



Note: Higher values mean the appreciation, lower values mean the depreciation of HUF.
Source: Bruegel Institute based on Darvas (2012)

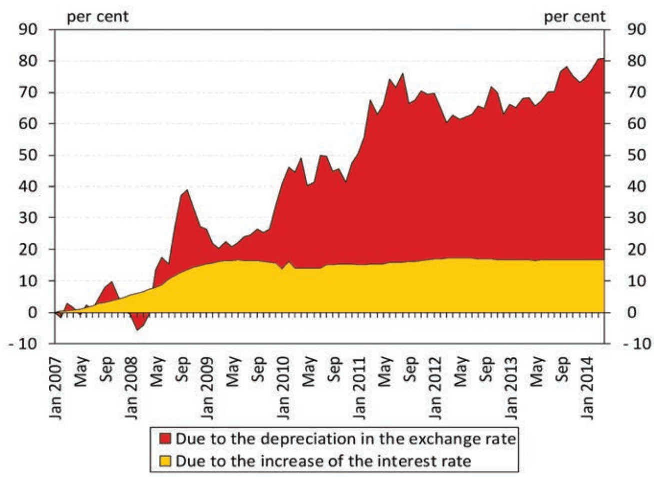
In addition to the macro-economic consequences, the impacts on debtors is also worthy of note. The realization of the exchange rate risk, as well as the unilateral interest rate increases by the banks substantially affected the amount of the credit instalments. In respect to the interest rate increases, the comparison with Polish FX-loans is especially interesting, these already being linked to the reference rate before the crisis. In their case, the base rate reductions of the Swiss central bank following the outbreak of the crisis were priced in the mortgages completely. Conversely, in Hungary, the banks – as previously mentioned – increased the interest rates (Figure 20:). Due to the two impacts, the credit instalments sometimes increased by up to 80 per cent in the case of a typical mortgage (Figure 21:).

Figure 20: Average interest rate of the outstanding FX-denominated loans



Source: National central banks of these countries

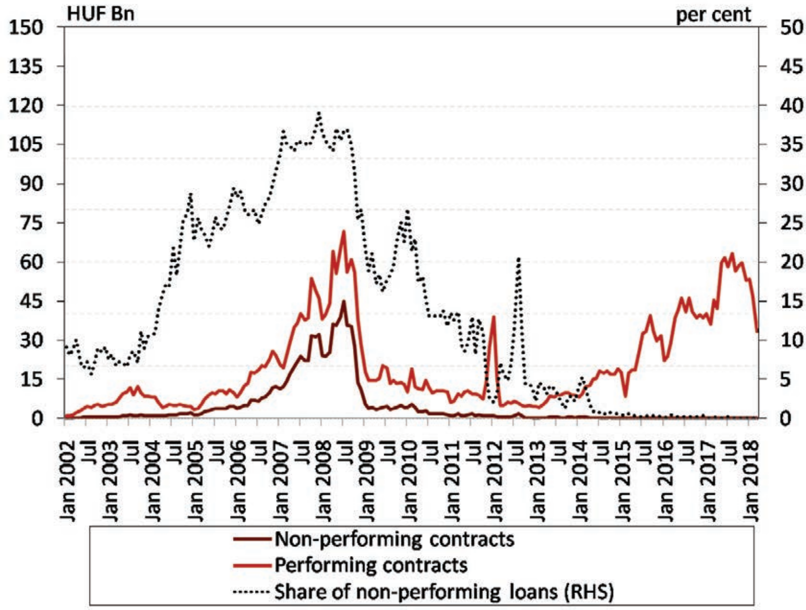
Figure 21: The fluctuation of an average housing loan's instalments compared to the initial value



Source: Own calculation

The increasing instalments led to the spread of non-performing loans. Especially those loans proved to be the most problematic that were disbursed during the one and a half years prior to the outbreak of the crisis, in the most intense period of competition. Nearly 40 per cent of these loans later became non-performing, and their share was still 60 per cent within the non-performing loan portfolio in 2018 (Figure 22:).

Figure 22: Distribution of the household mortgage loan contracts outstanding at the end of March 2018 by rating category and the month of contract conclusion



Source: MNB (2018)

Overall, the financial crisis of 2008 found Hungary in an extremely vulnerable situation with high external debt, a current account deficit, and relying on foreign funds.

The correction of the imbalances took many years, although as a legacy of foreign currency lending several tens of thousands of families were still struggling with a debt service that they could not pay easily in 2018. Although the situation was settled with the conversion of foreign currency loans into forint loans and the settlement of unilateral interest rate increases, during their tenure FX-lending caused immense damage to the economy.

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BEYOND FINANCES: WHY DO NON-PERFORMING HOUSEHOLDS NOT PAY?[1]

[1] *This study contains the views of the authors and does not necessarily reflect the official position of the MNB.*

The financial crisis of 2008 found Hungarian mortgage credit debtors in a vulnerable situation, due to which the ratio of non-performing loans increased to a high level. The aim of our study is to identify those factors, which have an influence among non-performing or restructured mortgage credit debtors in respect to what degree the debtor is able and willing to repay debt. We examined non-performing and restructured mortgage loans to see whether the outstanding debt decreased between January 2014 and January 2015, taking into account the income levels of debtors, the loan characteristics, as well as variables describing the settlement in which the debtor lives. Based on our logistic regression analysis, people who had a larger relative indebtedness, i.e. the loan-to-value rate was higher, and they had lower incomes and more dependants in their households, were less likely to reduce their debt. While carrying out our estimate, we also identified non-financial variables that might reduce the willingness to pay: if the debt of the debtor multiplied compared to the borrowed credit amount, if the loan was a home equity loan, or if there was a higher proportion of non-performing debtors in the given debtor's settlement. The social capital variable that we created at the settlement level also indicated an increase in debt in our models, while if the debtor had been in default for a relatively longer time, the same effect could be observed. It was also significant which institution owned the debt, a factor which might indicate that the recovery strategies of some institutions motivated clients to perform better, while others less.

1. Introduction

Due to the unhealthy structure of lending with a significant exchange rate risk by borrowers between 2004 and 2009, the emerging financial crisis found Hungarian households in a particularly vulnerable position. This also manifested in the increasing ratio of defaults: the proportion of non-performing household loans beyond 90 days in the credit institution sector first increased to 11 per cent in 2010, then to 19.3 per cent in 2013 from 3.8 per cent in 2008.

The biggest problem, which remains the case today, stemmed from non-performing mortgage credit households. Mortgage loans, due to their unique nature (large credit size, long maturity), may well define the finances of debtors for decades to come. These loans are also special in respect to their underlying collateral – property – that theoretically provides a potential exit strategy for the debtor from the transaction, if serving the debt becomes too onerous. However, such a strategy can become problematic if prices fall on the real estate market, or the outstanding amount of the loan increases. Due to the denomination in foreign exchange and the stagnation of the housing market in Hungary, both factors were applicable so in many cases the loan-to-value ratio increased by over 100 per cent.

The risks of mortgage loans caused tension not only for the debtors, but also for the domestic banking system. In 2013, the entire financial system had over 164 thousand non-performing mortgage credit contracts. Due to the growing ratio of defaults and the reduction of collateral values, the banks were forced to provision a considerable rate of loan losses on the household credit portfolio, to the total amount of HUF 1,750 billion between 2008 and

2014, not including the quarters of early repayment. This amount represented 83 per cent of the regulatory capital as of the end of 2008.

The aim of our study is to identify those factors, which have an influence among non-performing or restructured mortgage loan debtors to what degree such debtors are able and willing to repay the debt. During the analysis we concentrated not only on the financial features in the strict sense (income, loan-to-value ratio), but also integrated certain non-financial indicators in the scope of our analysis, for example the level of social capital typical for the residence of the debtor.

The study is structured as follows; we will summarize the relevant literature in Chapter 2, by which we will partly demonstrate previous studies regarding our domestic households, and will partly discuss the conclusions of the international literature on non-performing loans. In Chapter 3 we will present our research approach, database and the methodology applied for data analysis. In Chapter 4 we will list the results, and finally in Chapter 5 we will summarize our conclusions.

2. Literature review

Both in the relevant national and international literature we find relatively few studies regarding why the non-performing debtors remain in default, and also what proportion of the debt service they can repay after falling into default status. The majority of the analyses published on the domestic situation address the reasons why debtors fall into default, therefore we will discuss this topic next. Meanwhile, when discussing the variables explaining the situation of default, the relevant international literature places a great deal of emphasis on when it is worthwhile for debtors to default, i.e. under which circumstances they might strategically default.

2.1. Previous research on domestic mortgage debtors[2]

Several studies in Hungary have dealt with the reasons why loans fall into default, however the number is not as many as we would anticipate from the magnitude of the problem. The MNB (the Central Bank of Hungary) – primarily in its Financial Stability Reports – have analysed the problem numerous times, but mostly in respect to the banking system. The aim of the report of April 2012 was to identify the reasons for non-performance based on macro-economic variables due to the typically aggregated nature of the available data: based on the results the increasing exchange rates and interest rates, as well as the rise in unemployment explain approximately half of the defaults, primarily due to the previous two factors (MNB 2012).

Gáspár and *Varga* (2011) achieved a similar result with micro-simulation methods: based on their study the reason for non-performance was mainly the increase in instalments, whereas unemployment only played a minor role in the escalation of the problem. The study also concludes that the financial circumstances of some 50 per cent of non-performing debtors was already risky when they borrowed the loan and their default status would have taken place in any case even in the absence of the above-mentioned shock.

[2] Based on DANCSIK et al., (2015).

Hosszú (2011) and *Balás* (2013) point out, based on micro-level data, that the problem was the concentration of household indebtedness (primarily in the balance sheet of the population on lower incomes), even if the aggregate indebtedness of the household sector did not stand out by international comparison.

Szigel and *Fáykiss* (2012) focus on the amount of interest rates paid by the households, and also point out that the risks are higher than what the size of the outstanding stock implies. The study concludes that the indebtedness of the sector based on the amount of interest to be paid is a lot more serious than it seems based on the outstanding debt, i.e. the debtors "flow" leverage is higher than the "stock" leverage.[3]

Out of the studies that have been published so far, the most detailed descriptive analysis was provided by *Dancsik et al.* (2015), primarily based on the circumstances of debtors at the end of 2014. The main observations of the study confirmed that the reduction of non-performing retail mortgages was typically hindered by the excessive indebtedness of debtors, i.e. high instalments and the large volume of outstanding debt. However, a significant proportion of the non-performing population has some income, i.e. substantive “restructuring reserves” can be identified in the portfolio, however, the banks are not active enough in exploiting these reserves. The study establishes that due to the lack of consequences of non-payment, a considerable segment of the non-performing portfolio (10 per cent to 20 per cent) were typically less willing to pay, which is also underlined by the experiences of lenders. Figure 1 indicates the segmentation of debtors according to their ability and willingness to pay.

Figure 1: The composition of non-performing debtors based on the ability and the willingness to pay

		Redemption made in one year			
		No redemption	Moderate redemption	Substantive redemption	*Total*
Ability to pay based on declared income	Sufficient income for debt service	11%	3%	5%	*19%*
	Too high debt compared the income	23%	11%	9%	*43%*
	No income	24%	7%	7%	*38%*
	Total	*58%*	*21%*	*21%*	*100%*

Note: Sufficient income for debt service category: the payment-to-income (PTI) is less than 30 per cent (in the case of a valid contract), or the ratio of the outstanding debt and annual income is less than four (in the case of a terminated contract). The debt is too high compared to income: the PTI exceeds 30 per cent (valid contract), or the ratio of the credit amount and annual income is greater than four per cent (terminated contract). Moderate redemption: the debtor pays 1 per cent to 80 per cent of the payment obligation due between January 2014 and January 2015 (in the case of a valid contract). Substantive redemption: the debtor pays at least 80 per cent of the payment obligation (valid contract), or can reduce the overall debt (terminated contract).

Source: MNB (2016) p. 8, MNB mortgage loan database.

[3] See BERLINGER et al., 2012

The magnitude of the problem remained substantial even years after the outbreak of the crisis, despite the fact that the Government tried to moderate the consequences with numerous measures. On one hand, following the outbreak of the crisis, in order to prevent a major social crisis the Government significantly aggravated the implementation of collateral vindication (moratorium on evictions, quotas on foreclosures). On the other hand, in order to manage the problem several other measures were also introduced (preferential early repayment option, exchange rate cap, conversion into forints with 25 per cent debt relief, National Asset Management, settlement and conversion into forints, Family bankruptcy protection),[4] which provided an escape route from a difficult situation for a wide range of debtors. However, the measures not only influenced the debtors' situation *ex post,* since by forming expectations they also subsequently modified their behaviour. According to a questionnaire survey conducted in 2015, about 80 per cent of non-performing debtors did not agree with the statement that the Government had already provided a lot of help to debtors and further measures relating to the problem could not be expected.[5] The continuous sustainment of Government support and the reduction of default costs contributed to the fact that the ratio of debtors, which can be characterized by moral hazard, became substantial.

The aforementioned analysis also concludes that in Hungary, as of 2014, the opportunities for collateral sales were limited. The voluntary sales of collateral or selling via the bank were substantively limited by the local features of the real estate market in the case of some debtors. A considerable part of collateral is in such regions and settlements where, due to the weaknesses of the real estate market, the market-base sales might be hindered, aggravating the cleaning of the portfolio. Finally, administrative limits make the successful management of the problem more difficult, especially in respect to the terminated loan contracts. The costly and extended foreclosure proceedings, the ambiguous taxation regulations in certain areas and the problematic restructuring of terminated loans pose a risk to the cleaning of the non-performing mortgage loan portfolio.

2.2. International literature review

The focus on the analysis of non-performing loans in foreign literature is on a far wider scale than the Hungarian one. One branch of literature is attempting to identify the factors which impact the debtor's default status through micro-economic modelling (however, in many cases this is supplemented by empirical testing).

Schelkle (2018) distinguishes between two large areas within the micro-economic models. According to one type of model,[6] falling into default is basically an option. The debtor will default when the value of this option is positive, and not expected to grow any further. The option nature of defaulting, however, is not an option in every country: the designers of the model typically examined the problem of non-performing mortgages in countries where the so-called *"walk away"* right is in effect, i.e. by giving up the collateral, the debtor is relieved

4 For details on these measures, see a study by DANCSIK et al., 2017.

5 DANCSIK et al., 2015

6 See for example KAU, KEENAN and KIM, 1994, KAU et al., 1992, 1995, QUERCIA and STEGMAN, 1992, KAU and KEENAN, 1995, and also VANDELL, 1995

of paying the entire debt. In this case the value of the option is positive, if the LTV-ratio (loan-to-value, i.e. the ratio of the loan to the collateral value) exceeds 100 per cent.

As per the other type of models, the negative equity (i.e. an LTV rate over 100 per cent) is a necessary, but not sufficient pre-condition for being in default. It has two main reasons: on one hand, an LTV rate over 100 per cent is to no avail, if the additional reduction of the collateral value is anticipated, as in this case the value of the walk away option is expected to increase and is not necessarily worth utilizing at present. On the other hand, practising the walk away right has transaction costs: "utility" stemming from living in the given property ceases, and moving involves actual financial costs, while the debtor has to suffer social consequences (social stigma) as well, if he returns the property to the bank.[7] These social expenses are by no means negligible: according to research by Fannie Mae (2010), the majority of people consider it morally reprehensible, if someone stops paying his mortgage while actually still being able to pay it. *Guiso* et al. (2013) confirm that in addition to financial considerations, the ethical and moral views of debtors also influence the probability of default in the event of negative equity, while how others decide in similar situations, has an effect as well. In addition, *Bhutta* et al. (2017) draw attention to the fact that emotional and psychological reasons also play a role in defaulting and in refraining from non-performing. *Agarwal* et al. (2011) investigate the probability of starting bankruptcy proceedings, and they find that the size of both the individual and the local social capital also play a role in these decisions.

Overall, it can be established that the phenomenon of entering into default is deeply embedded in a social sense, so if it is examined solely from a financial point of view, incomplete conclusions may be drawn.

Contrary to optional theory, according to the so-called *"double-trigger"* hypothesis, besides negative equity a life event must also take place to trigger the default status, for instance a divorce, or the loss of a job.[8] Negative capital is the pre-condition for falling into default, because under a 100 per cent LTV-ratio the debtor can theoretically prevent the default status by selling the property.[9] There are two implicit key assumptions behind the double-trigger hypothesis. One is that should the debtor fall into default, he/she will suffer negative consequences, therefore non-performance is fundamentally to be avoided. The second is that properties can be sold on the market, which, however, is not necessarily plausible amidst a stagnating housing market. If these two conditions are not applicable, under a 100 per cent LTV ratio, or in absence of a life event, the default position might still arise.

3. Research question, methodology and data

3.1. Research question and possible explanatory variables

Based on the conclusions of the relevant literature, it can be observed that the choice regarding non-performing status is the final result of a rather complex decision influenced by multiple factors. It could be observed that the financial and wealth situation of the debtor

7 WHITE, 2010.

8 SCHELKLE, 2018.

9 FOOTE and WILLEN, 2018.

have considerable roles: the ratio of the loan to the collateral value is imperative (is the debtor able to withdraw from the contractual relationship by selling the property), as are the liquidity problems of the debtor (due to either rising instalments, or reduced household income, e.g. as a consequence of losing a job, or divorce). Beyond the financial aspects however, the fact of whether the debtor considers his or her default morally acceptable also plays an important role, in the same way as popular non-performing among his/her peers.

In a situation where the financial consequences of defaulting are more uncertain, the significance of "costs" in respect to the moral views of the debtor might increase. From the vantage point of pure financial utility, if the debtor feels that being in default is not penalized by the foreclosure of the property, it is worth giving up the payment obligation, and entering onto a path of higher consumption through the released liquidity. This positive incentive might be softened by the debtor's moral attitude, or the degree of the perceived social stigma, which basically appears as a psychological cost to the debtor, and might offset the utility surplus that can be obtained by the increased consumption.

It is an especially interesting phenomenon in Hungary, where the problem of non-performing loans was of a different magnitude than in the examples of Western European countries or the United States, examined by the international literature. Foreign currency denominated lending also makes the Hungarian situation unique, since with this product an extremely wide scope of debtors came to feel that paying instalments was useless, as the remaining debt was increasing anyway due to the depreciation of the exchange rate. In such a situation – which could well violate many debtors' sense of justice –, it is not clear what moral behaviour means to the individual: the repayment of debt, or the rejection of a claim considered as exorbitant.

However, the moral stance of the debtor is a variable, which is quite difficult to observe, especially when not working with questionnaire data. Therefore, when we created the models we assumed that the size of the *social capital* for the settlement that serves as the residence for the debtor might be related to psychological expenses brought about by non-performing.

Currently, there is no standard definition for the concept of social capital. In respect to economics, the phrasing that defines social capital as a skill for social cooperation might be the most plausible one. In respect to the individual, social capital is therefore the willingness to make an individual sacrifice for the community to achieve a higher collective utility level.[10] The fundamental building block of social capital is trust, as well as the density of the social network, i.e. the number of interactions between people in the given society.

Social capital is connected to many processes related to the banking system: the probability of households entering bankruptcy,[11] the development of the financial system,[12] the stability of credit institutions,[13] and even the interest rate spread of corporate liabilities.[14]

10 In respect to game theory, it all corresponds to an n-player prisoner's dilemma situation: in cases where the players are characterised by higher social capital, a balance is more easily found, whereas the players following the deserter strategy are fewer, and the cooperative players form a larger proportion.

11 AGARWAL et al., 2011

12 GUISO et al., 2004

13 OSTERGAARD et al., 2016, JIN et al., 2017

14 HASAN et al., 2017

Based on the above, it seems a plausible statement that social capital might play a role in the choice of domestic households when they decide whether or not to service the debt. The impact of government measures reducing the probability of foreclosures could be offset, if the debtor feels that by not paying he/she damages society,[15] or he/she is concerned about being stigmatized if the debt is not paid. In this regard we are relying on a positive relation between social capital and the willingness to pay.

However, considering that the foreign exchange credit debtors find the extreme extent of the realized exchange rate risk unfair in many cases, it is possible that social solidarity will steer them in the opposite direction, and a "cooperative" act would be to unite against the lenders and not pay the debt service. If this attitude spreads throughout a wide spectrum of society, an opposite indicator of the relationship between social capital and the willingness to repay debt may be experienced.

3.2. Database

In order to make a more detailed analysis of the problem of non-performing credit debtors, in the summer of 2015, the MNB requested contract-level data from market participants with the most substantial non-performing mortgage loan portfolios. Within the framework of this one-off data service, 14 financial institutions – 12 banks, one branch of a foreign institution and one financial corporation – provided data for the mortgage loan database (hereinafter referred to as: MNB mortgage loan database). The database contains around 229 thousand problematic mortgage contracts, the total outstanding debt of which was in excess of HUF 1,600 billion on 30 April 2015 (Table 1), while the debt, including overdue interest payments and fees, amounted to HUF 1,780 billion.

The available database contains the selected data (data available from the financial institution describing loan characteristics, the income situation of the debtors, the value of the mortgage collateral, and any possible restructuring) of restructured retail mortgage credit transactions, and those exceeding 90 days on 31 January 2015. The database contains records dating from 30 April 2015, from financial institutions with at least one thousand non-performing retail mortgage credit contracts – covering 86 per cent of the non-performing portfolio of the time.

To analyse the debtors' income situation and debt service based on objective data we obtained the income and tax burdens – listed in their personal income tax returns – from the National Tax and Customs Office regarding the last two completed tax years of debtors and co-debtors,[16] as well as all other credit debt of the debtors and co-debtors from the Central Credit Information System (KHR). We linked the data regarding income and debt service with the records acquired from the monetary institution while, of course, fully complying with the principle of anonymity.

[15] This realization also certainly requires that the debtors are clear about the consequences of their actions, which is not necessarily taken for granted in the case of a complex system of institutions, like the financial system. During the operationalization of social capital, it therefore might be worth supplementing the classical indicators with some educational indices. Higher education typically means higher financial culture as well (OECD 2016, 31.), so a more educated debtor will more likely see the consequences of their actions, which is the pre-condition for moral decisions.

[16] Tax years 2013 and 2014.

Table 1: The outstanding principal debt of non-performing and performing restructured mortgage loans listed in the mortgage loan database and the number of contracts in a breakdown by delinquency prior to settlement

HUF Bn	Performing restructured			Nonperforming			Total		
	Gross	Net	Number of contracts	Gross	Net	Number of contracts	Gross	Net	Number of contracts
Valid contracts	**493.0**	**442.2**	**83.979**	**500.8**	**258.9**	**64,997**	**993.7**	**701.1**	**148,976**
CHF	364.6	333.3	52,562	408.7	204.8	47,926	**773.4**	**538.1**	**100,488**
EUR	25.0	22.3	3,774	47.5	27.1	6,756	**72.6**	**49.3**	**10,530**
HUF	99.6	83.2	27,243	38.9	22.6	9,698	**138.5**	**105.8**	**36,941**
JPY	3.7	3.4	400	5.6	4.4	617	**9.3**	**7.9**	**1,017**
Terminated contracts	**2.7**	**1.4**	**808**	**621.0**	**333.8**	**78,809**	**623.7**	**335.2**	**79,617**
CHF	0.8	0.4	87	524.6	268.4	56,433	**525.4**	**268.9**	**56,520**
EUR	0.1	0.0	8	21.8	9.4	3,400	**21.9**	**9.4**	**3,408**
HUF	1.8	0.9	713	60.1	42.7	17,538	**61.9**	**43.6**	**18,251**
JPY	0.0	0.0	0	14.5	13.3	1,438	**14.5**	**13.3**	**1,438**
Total	**495.7**	**443.6**	**84,787**	**1,121.7**	**592.7**	**143,806**	**1,617.5**	**1,036.3**	**228,593**

Note: Outstanding principal debt amounts as of 30 April 2015. Source: MNB mortgage loan database.

The database contains the following main variables by contract:

- Type of product (housing loan or home equity loan)
- Amount and composition of debt (not yet due items and items past due) for the dates of January 2014, January 2015 and April 2015
- The original contracted amount of the credit
- The amount of other loans
- The declared taxable (personal income tax) income of the debtor and co-debtor
- Where we had data about taxable income, we also knew the number of dependants
- The date of the oldest default as a category variable (the categories are: 0–30 days, 31–90 days, 91–180 days, 181–360 days, 361–720 days, over 720 days)
- Market value of the collateral
- The settlement where the debtor resides
- The financial institution that owns the claim

We supplemented our data with the following calculated variables:

- The rate of the loan-to-value (LTV)
- A binary variable, which specifically controls for negative equity (i.e. its value over 100 per cent LTV is 1, under is 0)
- The ratio of the debtor's debt and income
- The ratio of the outstanding debt as of January 2014 and the borrowed amount, and
- The local social capital variable based on settlement data.

3.3. The measurement of social capital

The concept of social capital became the central item of social theory from the 1990s, primarily following *Coleman's wor*k.[17] The concept is addressed by several sociologists,[18] due to which two main directions were created, followed by their synthesis in the literature: individual and collective social capital. They seem to agree that social capital prevails through the social relationship network and promotes action.[19] Social capital can work via information flow, mutual help norms, collective development and competitiveness, collective action and social cooperation, or through collective consciousness, trust and solidarity.[20]

In respect to the measurement of social capital, as stated above, no standard approved methodology is available. As per Fukuyama, there are two basic approaches: one is based on the number of social groups and group members, the other is on collective trust and the extent of civil organizations.[21]

The concept of social capital is complex; therefore it is not surprising that different research identified it with different variables. *Orbán* and *Szántó* (2005) presented the measurement method of Putnam state, that *"obviously the exact measurement of the social capital volume is an almost impossible mission, since it is partly based on subjective, estimated, or even non-existing data, which is difficult to collect."* Therefore, a study on social capital can be (partly) carried out mostly though data collection using a questionnaire, which generally assesses the extent of (institutional) trust and civil society.

The studies addressing the relationship between the banking system and social capital frequently use variables that capture the relationship between the individual and the community. *Guiso* et al. (2004) for instance measure the degree of social capital by participation in elections and the ratio of blood donors. *Jin* et al. (2017) also use election data, *Hasan* et al. (2017) use election participation data and the number of civil organisations, while *Osteergard* et al. (2016) use the proportion of newspaper subscriptions and the volume of charity donations as a yardstick.

During our research, we had to take into consideration that individual social capital elements cannot be linked to the debtor-level database, in respect to the data source and the content of variables. Since we had to comply with the requirement of anonymity and would have had to analyse a high number of debtors, we were not able to carry out a questionnaire-based survey of individuals. However, we had information about which settlement the properties were registered at as mortgage collateral. Consequently, we connected the debtors with the social capital level characteristic for the settlement.[22]

Once we decided this, we operationalized social capital to use it as a predictor in the regression analysis. The willingness to participate in elections, the extent of the civil sphere (a total of 54

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17 ORBÁN–SZÁNTÓ, 2005

18 See for example BOURDIEU, 1998; FUKUYAMA, 1997, 1999, 2000; PUTNAM, 1993, 2000; and COLEMAN, 1994, 1998.

19 COLEMAN, 1998. 17.

20 PUTNAM, 2000, summarizes ORBÁN–SZÁNTÓ, 2005

21 FUKUYAMA, 1999, 6-9.

22 It is worthy of note that this solution (1) presumes a settlement-level homogeneity, which should be addressed in a regression analysis, (2) during the interpretation of results it must be taken into account that the individual does not necessarily have those social capital elements, which characterizes the settlement, e.g. it is possible that the debtor did not participate in the parliamentary elections, whereas the settlement in total participated to an extent that is above the national average.

thousand organisations) and levels of education were considered as the components of social capital as settlement-level variables.[23] The content of each variable is presented in Table 2.

Table 2: The operationalization of social capital elements

Concept	Variable content	Expected correlation with social capital
Willingness to participate in elections	Participation rate at parliamentary elections in 2014 (per cent)	positive
Extent of the civil sphere	Number of NGOs per thousand inhabitants (pieces)	positive
Education	Percentage of the population with tertiary education (per cent)	positive

Note: The source of election participation data was the National Election Office, while the number of civil organisations and population with tertiary education were applied based on the national census of the Hungarian Central Statistical Office in 2011.

To measure social capital on a settlement level, we assessed these specifics in every national settlement. The distribution of each applied variable by settlement covers a substantial heterogeneity, which can mainly be detected in the right-skewed distributions, therefore, we had to filter out the outliers. In the case of election participation and university/college degrees, we applied an outlier filter at the 1st and 99th percentile values, while we only filtered out the top 1 per cent of the number of civil organisations (Table 3). Following the outlier filtering, the frequency distribution of certain variables can be seen in Fig. 2.

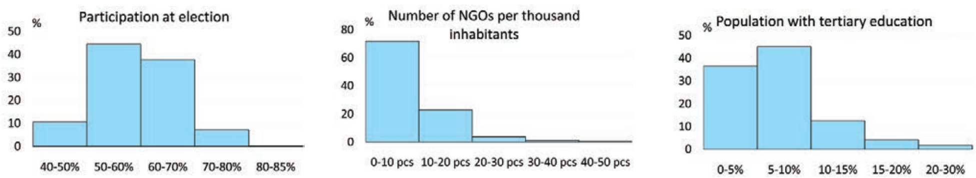
Table 3: Characteristics of the applied social capital elements' distribution

		Percentiles							
Variable	Minimum	1%	5%	25%	50%	75%	95%	99%	Maximum
Participation rate at elections (per cent)	29.9	41.4	47.0	53.9	59.2	64.5	73.1	80.6	100.0
Number of NGOs per thousand inhabitants (pieces)	0.0	0.0	0.0	4.6	7.2	10.7	22.6	51.3	1500.0
Percentage of the population with tertiary education (per cent)	0.0	0.3	1.5	4.0	6.0	8.8	17.1	26.7	50.7

Source: Own calculation.

[23] During the analysis, we assumed that many other settlement-level variables available are related to each other, and together to social capital, which cannot be observed directly. These were the permanence of population (number of in-and outbound migrants to the residents), the renewal of the housing stock (number of newly constructed homes to the housing stock), the stability of family structure (number of divorces to the number of residents), labour market stability (number of job seekers to residents), religious and ethnic heterogeneity (proportion of non-religious and non-Hungarian population). During our analysis we found that the listed variables are not in relation to each other, by which they would support an integrated social capital concept. Therefore, the measurement of this requires further investigation.

Figure 2: Frequency distribution of the applied social capital elements



Source: Own calculation.

We created one principal component out of the three variables, which hereinafter we will call social capital. Thus, we considered social capital as a latent variable, and the used variables as dimensions, through the observation and combination of which the latent variable can be created. The social capital principal component covers 51 per cent of the variance of the three variables (Table 4).

Table 4: The correlation of the applied variables to the social capital principal component

Variable	Correlation with the principal component	Variables' variances captured by the principal component
Participation at elections	0.64	62.3%
Number of NGOs per thousand inhabitants	0.48	35.0%
Proportion of the population with tertiary education	0.60	55.5%

Source: Own calculation.

Therefore, the social capital principal component can be interpreted as representing the settlement-specific (1) willingness to participate in elections, which expresses institutional trust; (2) extent of the civil sphere, which shows trust in the local community; and (3) high level of education, which defines the opportunity to access resources.

3.4. Methodology

The available databases – although containing certain variables for several dates – is cross-sectional. We selected a binary variable as the dependent variable of the model, which takes the value of 0, if the debt of the debtor decreased between January 2014 and January 2015, and takes the value of 1, if the debt has not changed, or increased during the same period.

$$Debt\ amount\ change = \begin{cases} 0, & if\ the\ debt\ decreased\ between\ Jan\ 2014\ and\ Jan\ 2015 \\ 1, & if\ the\ debt\ did\ not\ decrease\ between\ Jan\ 2014\ and\ Jan\ 2015 \end{cases}$$

The change in the amount of debt is an appropriate variable as it can be interpreted both in the case of valid and terminated credit contracts. As a contrast, calculations based on instalments cannot be interpreted in the case of terminated loans, considering that the contractual relationship has terminated. There is therefore no instalment due from the client, but the entire debt becomes due at the time of such termination. We chose the start and end date for the variable taking into account that it should not be influenced by the measures regarding foreign currency loans as of February 2015, which concerned the amount of the outstanding debt. During the calculation of the variable we controlled for the exchange rate fluctuation.

Considering that a binary variable is the dependent variable, the following binary logistic regression function was estimated for the applied variables:[24]

$$ln\left[\frac{P(y=1|x)}{1-P(y=1|x)}\right] = \alpha + \sum_j \beta_j x_j + \sum_k \gamma_k t_k + \delta w$$

where xj means the debtor-level characteristics, tk means the settlement-level characteristics, i.e. social capital and the share of non-performing debtors in the settlement, and w is the control variable representing the economic development of the settlement and the proportion of job seekers.

Equivalent to this expression for the realization probability of the event (debt did not decrease):

$$P(y=1|x) = \frac{e^{\alpha+\sum_j \beta_j x_j + \sum_k \gamma_k t_k + \delta w}}{1 + e^{\alpha+\sum_j \beta_j x_j + \sum_k \gamma_k t_k + \delta w}}$$

The independent variables of the logistic regression model are linear in the so-called logit function, while they are exponential in the

$$\frac{P(y=1|x)}{1-P(y=1|x)} = \frac{P(y=1|x)}{P(y=0|x)}$$

odds of the outcome. So the βj sign of the coefficients indicate that the increasing level of the concerned independent variable increases, or decreases the probability of the y=1 outcome of the binary dependent variable on average (however, it does not show the precise extent of the impact regarding the probability of realization). The eβ values calculated from the estimated regression coefficients specify on average how many times per unit the independent variable (presuming that all other factors remain unchanged) raises the odds in the examined outcome. Therefore, the coefficients do not provide a precise indication in respect to the probability of an decrease or increase in debt.

During modelling we had to take into consideration that the values of the social capital and the control variables of debtors living in the same settlement[25] are equal, so we calculated clustered standard errors for the regression coefficients.[26]

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24 For the descriptive statistics of applied variables see the Appendices .

25 Precisely, those debtors who borrowed loans with mortgage collateral located in the same settlement.

26 For more information about this method, see CAMERON–MILLER, 2015

4. Results

The results of the estimated logit models are in Table 5. Since the dependent variable takes value 1 if the client's debt increased or did not decrease during the examined period, the positive coefficients mean the factors pointing towards the increase or stagnation of debt, whereas the negative coefficients are the factors increasing the probability of the reduction of debt.

Out of the applied independent variables, the following increased the probability of an increase in debt.

If it was a home equity loan. If the non-performing loan is a home equity loan, – controlling the income and indebtedness status, and other characteristics of the credit – the debt of debtors was less likely to decrease. This result is consistent with the image that can be seen from the aggregated statistics, which shows that the NPL-rate in the case of home equity loans is a lot higher than in the case of housing loans. This could indicate the higher risks of the group (which is already reflected by the indebtedness for consumption),[27] which is not only reflected in the non-performing status, but also the lower redemption ratio.[28]

If the debtor has been non-performing for a relatively longer time. The binary variables marking certain default categories are significant in most of the estimates, and along with the growing default category the size of coefficients also typically show an increasing tendency. This means that in the case of debtors with a longer default status, the probability that they were not able to reduce their debt between 2014 and 2015 is higher. This indicates that if the debtors are in default for a long time, this state can easily become permanent.

[27] Besides the purpose of consumption, it would also be worth examining whether there is different willingness to pay in the case of housing loans with investment purposes. However, we did not have any information in the database regarding this.

[28] However, we are not able to clearly state that the positive sign of a variable means an attitude or an ability problem. It is possible that these debtors originally had lower incomes during the disbursement of the credit, and accumulated lower savings, and this was reflected in subsequently lower instalments. It is also possible that the consumption purpose indicates that the debtors' income volatility is higher, which we are also not able to control with the variables in our database.

Table 5: Estimated results, dependent variable: 1 = the debt increased, or did not change, 0 = the debt decreased

Independent variables	*Total sample*	*Debtors with over 90 days of delinquency*	*Debtors with income*	*NPL-debtors with income*	*Debtors outside Budapest*
Home equity loan dummy	0.164***	0.245***	0.192***	0.298***	0.171***
	(-0.0161)	(-0.0211)	(-0.019)	(-0.0249)	(-0.0153)
Terminated loan dummy	-0.711***	-0.542***	-0.705***	-0.485***	-0.688***
	(-0.0337)	(-0.0324)	(-0.0408)	(-0.0382)	(-0.0342)
31-90 days delinquency dummy	-0.0853***		-0.0257		-0.0898***
	(-0.0308)		(-0.0335)		(-0.0322)
91-180 days delinquency dummy	0.357***		0.435***		0.359***
	(-0.0312)		(-0.0374)		(-0.0324)
181-360 days delinquency dummy	1.329***	1.017***	1.389***	0.999***	1.332***
	(-0.0323)	(-0.034)	(-0.0364)	(-0.0407)	(-0.0337)
361-720 days delinquency dummy	2.924***	2.680***	3.006***	2.678***	2.922***
	(-0.0366)	(-0.0403)	(-0.0424)	(-0.0468)	(-0.0373)
721+ days delinquency dummy	2.834***	2.727***	2.873***	2.660***	2.838***
	(-0.0365)	(-0.04)	(-0.0434)	(-0.0473)	(-0.0385)
Social capital	0.0620***	0.0751***	0.0635***	0.0860***	0.0573***
	(-0.00755)	(-0.00888)	(-0.00891)	(-0.0111)	(-0.00797)
Ratio of NPL debtors among the population of the settlement	5.102***	4.907***	4.906***	4.747***	5.283***
	(-0.807)	(-1.03)	(-1.004)	(-1.359)	(-0.814)
Restructured loan dummy	-0.334***	-0.224***	-0.255***	-0.166***	-0.345***
	(-0.0224)	(-0.0264)	(-0.0273)	(-0.0314)	(-0.0228)
Amount of debt in January 2014 compared to the borrowed credit amount	0.997***	0.873***	1.069***	0.892***	0.969***
	(-0.0288)	(-0.0305)	(-0.0338)	(-0.0353)	(-0.0281)
Debtor has income dummy	0.678***	1.250***			0.680***
	(-0.12)	(-0.164)			(-0.125)
Logarithm of the annual income in 2014	-0.0502***	-0.0964***	-0.0539***	-0.110***	-0.0513***
	(-0.0084)	(-0.0116)	(-0.00887)	(-0.0123)	(-0.00872)
LTV	0.0144***	0.0110***	0.0141***	0.0105***	0.0146***
	(-0.000345)	(-0.000455)	(-0.000396)	(-0.000523)	(-0.000365)
LTV over 100 dummy	0.904***	0.470***	1.013***	0.602***	0.953***
	(-0.0647)	(-0.0821)	(-0.0715)	(-0.0913)	(-0.0675)
LTV * LTV over 100 dummy	-0.00924***	-0.00394***	-0.0101***	-0.00462***	-0.00974***
	(-0.000543)	(-0.000698)	(-0.0006)	(-0.000775)	(-0.000566)
Change in average square metre prices in the debtor's settlement between 2008 and 2014	-0.000507	-0.00213***	-0.000294	-0.00182*	-0.000444
	(-0.000677)	(-0.000804)	(-0.000802)	(-0.000997)	(-0.000673)
Proportion of job seekers in the settlement	0.0216	-0.0306	-0.0286	-0.0916	0.0398
	(-0.0706)	(-0.0862)	(-0.0837)	(-0.106)	(-0.0709)
Number of independants			0.0321***	0.0443***	
			-0.00781	-0.0098	
Bank dummies	Significant	Significant	Significant	Significant	Significant
Constant	-3.224***	-2.403***	-2.789***	-1.058***	-3.181***
	(-0.0649)	(-0.0745)	(-0.145)	(-0.185)	(-0.0653)
Number of observations	165,660	110,435	114,738	70,253	152,916

*** p<0.01, ** p<0.05, * p<0.1

Note: The standard errors are in brackets. Source: Own calculation.

The higher the loan-to-value ratio. Based on our model results, the growth of the loan-to-value ratio indicated as a continuous variable increases the probability of the debt increase. The binary variable controlling LTV over 100 (i.e. negative capital), which is indicated in the model is also significant, and its coefficient is positive, while the interaction of the continuous variable and the binary variable had a negative coefficient. This shows that it makes a big difference whether the transaction LTV is over 100 or not, but over this level the increasing LTV has a smaller impact on repayments by the client.[29] However, the problem of reverse causality arises in connection with the variable: if the clients, who currently do not pay their instalments, also did not previously pay, the debt (and the LTV) increases due to this attitude. In order to filter out this problem, we ran our models for each default category separately as well (Table 6), and we found that the coefficient of the variable is significantly positive if we only observe the debtors whose default status is relatively new.

The higher number of dependants. The odds to increase the client's debt was increased by being responsible for more dependants. A higher number of dependants increases the cost of living for the household and reduces the volume of income to be used for debt service. Therefore, this variable can also be considered as a trait of excessive indebtedness.

If the ratio of non-performing debtors is higher[30] among the population of the settlement. If there are relatively more non-performing debtors in the debtor's settlement, the odds of the debtor's debt not moderating also increases. This result corresponds with the statements of literature, according to which if the debtor sees enough examples in their environment of non-performing status, the social "cost" related to non-performing also falls, and his/her willingness to pay will also decrease. Since our entire database contains performing debtors as well (through restructured transactions), in the case of the result of the estimate run for the full sample the suspicion arises that the variable merely captures the obvious relationship between the share of non-performing transactions at the settlement level and the probability of non-performing at the debtor's level. Consequently, we ran the estimate for the sample of non-performing debtors only, in which case we also received a positive coefficient for the variable. The increasing NPL ratio within the settlement might also reflect the impact of a local economic shock (e.g. an international company shuts down its local factory), although we made adjustments for this using the ratio of job seekers in the settlement.

The higher the amount of debt, as of January 2014, compared to the borrowed credit amount. Based on the estimated results, the higher the client's debt grows compared to the date of borrowing, the higher the odds of further increasing debt. The clients' willingness to pay might be influenced if they observe that due to the depreciation of the exchange rate their outstanding debt is not reduced despite their payments. Similarly to our LTV variable, the suspicion of reverse causality also arises with this variable, therefore we also double-checked this result with the example of new non-performing debtors. We received a similar result with the latter estimates as well, which implies that the coefficient of the variable is not triggered by the debt increasing impact of previous defaults.

Social capital also increases the probability that the client's debt will increase. Our social capital variable is significant in all our models and its coefficient is positive. This result implies that the non-performing debtors are motivated by the "collective spirit" to continue non-paying. The positive coefficient of the variable supplementing our last two variables also support the view that debtors find the consequences of foreign currency lending unfair and where the organisational power of the community is higher, the probability of the debtors expressing their emotions in action and

[29] We also ran the estimate by indicating the ratio of the client's outstanding debt and income (only in the case of those debtors for whom we had income data). Our LTV variables remained significant in this case too, and their signs also did not change, therefore our LTV variable does not simply capture excessive indebtedness.

[30] Compared to the voting population.

stopping paying the debt is higher. The specific forms of these organisations may be different FX debtor groups, which advised their members to cease making payments in several cases.[31]

Out of the applied independent variables, the following *reduced* the probability of the increase in debt.

If the loan contract was terminated by the financial institution. The termination of the contract is the first step in the court enforcement of debt (and therefore foreclosure and eviction). This state could force debtors to increase their debt service to prevent the sale of their home at auction.

If the loan is restructured. The restructuring of debt service might ease the situation for the debtor, so the odds are better that the debtor will reduce the debt. The problem of reverse causality might also arise here: it is possible that the banks only provide discounts to those whose original situation was also not completely hopeless, and they have already paid part of the original debt service. In this case, the negative sign of the coefficient reflects the selection strategy of the banks, and not the positive impact of restructuring.[32]

If the income of the debtor is higher. Higher income increases the overall odds that the debtor is able to moderate the outstanding debt.[33]

Increase in the average square metre prices in the debtor's settlement between 2008 and 2014. Increasing housing market prices are only significant in some of the models, and on a 5 per cent or 10 per cent significance level, but typically with a negative sign. Therefore, where prices increased at a greater rate (or decreased to a lesser extent) between 2008 and 2014, this rather indicated a reduction of debt, but not to a substantial degree. This might be explained by the fact that the debtors were aware that the value of their property increases in relative terms and it motivated them to try to retain their properties.

31 The extent of such organisations is indicated by the fact that the "followers" of a group on one of the largest social media sites exceeds 21 thousand.

32 Bias could also be caused if the restructuring took place between the period we examined between January 2014 and January 2015, and contained debt relief. In this case, the negative correlation between the variable expressing the debt increase and the restructuring clearly applies, but it does not reflect the improving repayment ability of the client. However, this bias is minimized by (1), on the one hand, the majority of the restructuring occurring before the examined period, (2) and on the other hand, the restructuring of the transaction linked to debt relief was a quite rarely applied solution by the banks (DANCSIK et al., 2015).

33 Income was indicated in the model through two variables. On the one hand, since we had no income data for a part of the debtors, we controlled for it with a binary variable; on the other hand, the income logarithm was used in the model as a continuous variable as well. In the case of the latter variable, before transforming it into a logarithm we set the income to HUF 1 for those who had no income, so that we would not need to omit these data from the estimate. We addressed the uncertainty caused by the above by making an estimate only for those debtors where we had information regarding income. The coefficient of the variable was also significant in this case and had a negative indicator.

Table 6: Estimated results by default category, dependent variable: 1 = the debt increased or did not

Independent variables	***91-180 days delinquency***	***181-360 days delinquency***	***361-720 days delinquency***	***721+ days delinquency***
Home equity loan dummy	0.471*** (-0.058)	0.229*** (-0.0509)	0.120** (-0.0508)	0.345*** (-0.0305)
Terminated loan dummy	-0.604*** (-0.184)	0.308*** (-0.0897)	-0.679*** (-0.0601)	-0.355*** (-0.0459)
Social capital	0.0631*** (-0.0241)	0.0647*** (-0.02)	0.0723*** (-0.0223)	0.0924*** (-0.0118)
Ratio of NPL debtors among the population of the settlement	5.313* (-2.807)	4.382* (-2.49)	7.240*** (-2.806)	3.822*** (-1.442)
Restructured loan dummy	0.0903 (-0.0619)	0.250*** (-0.0535)	-0.097 (-0.0606)	-0.508*** (-0.0447)
Amount of debt in January 2014 compared to the borrowed credit amount	1.183*** (-0.0974)	0.685*** (-0.0821)	1.040*** (-0.0812)	0.768*** (-0.0375)
Debtor has income dummy	0.875* (-0.446)	0.932** (-0.383)	0.967** (-0.432)	1.711*** (-0.244)
Logarithm of the annual income in 2014	-0.0596* (-0.0314)	-0.0719*** (-0.0267)	-0.0694** (-0.0302)	-0.135*** (-0.0175)
LTV	0.0153*** (-0.00132)	0.0125*** (-0.000993)	0.000638 (-0.000953)	0.0140*** (-0.000627)
LTV over 100 dummy	1.394*** (-0.222)	0.962*** (-0.192)	-0.520** (-0.215)	0.540*** (-0.113)
LTV * LTV over 100 dummy	-0.0123*** (-0.00194)	-0.00942*** (-0.00161)	0.00698*** (-0.00172)	-0.00517*** (-0.000973)
Change in average square metre prices in the debtor's settlement between 2008 and 2014	0.0000588 (-0.00209)	-0.00358** (-0.00166)	-0.00232 (-0.00187)	-0.00237** (-0.0011)
Proportion of job seekers in the settlement	-0.0304 (-0.246)	0.114 (-0.207)	-0.263 (-0.221)	-0.0278 (-0.122)
Bank dummies	Significant	Significant	Significant	Significant
Constant	-4.361*** (-0.208)	-2.103*** (-0.174)	0.621*** (-0.182)	1.152*** (-0.123)
Number of observations	8,688	11,171	17,381	73,195

*** p<0.01, ** p<0.05, * p<0.1

Note: The standard errors are in brackets. Source: Own calculation.

In addition to the above variables, the impact of financial institutions which have the claim in their balance is not unanimous in respect to the probability of debt increase. We also controlled for certain financial institutions in the models with binary variables, which in most cases were significant with different indicators. This has a twofold implication: on one hand, the institution managing the claim is the same as the institution that originally disbursed the loan in many cases, so the institutional variables might reflect the previous risk profile of the bank and also the credit rating and risk of debtors. On the other hand, the level of activity of the workout varies from one bank to another: the intensity of client approaches and the nature of proposed restructuring are also different. This draws attention to the fact that the debtors' willingness to pay can be greatly influenced by the institution's approach to the non-performing debtors in their balance.

5. Conclusion

In our study we investigated problematic, domestic mortgage loans to determine the factors that influenced debtors in whether they were able and willing to reduce their outstanding debts between January 2014 and January 2015. We examined the subject with a regression model based on micro-level data supplemented by settlement-level variables.

Based on our results, the increase in debts are, on one hand, influenced by several characteristics of excessive indebtedness. The higher loan-to-value ratio (LTV) and lower income *ceteris paribus* increased the probability of an increase in debt. It has the same impact if the debtor is responsible for more dependants, which might also indicate the tension of his/her income status.

Beyond our results in respect to the financial situation of the debtor in a narrow sense, our estimates imply that debtors' behaviour – willingness to pay – might be influenced by other factors too. Those debtors, whose debt multiplied compared to the originally borrowed loan amount, are less likely to pay the debt, than the debtors who borrowed for consumption purposes. This has the same effect if proportionately more non-performing debtors reside in a given settlement, which demonstrates the potential role of social relationships. In order to examine the impact of social capital, we created a settlement-level variable with a principal component analysis as a combination of three settlement-level variables (participation ratio in the elections, the number of civil organisations per thousand people, the ratio of people with a university/college degree), which is significant and is included in our estimates with a positive coefficient. This implies that the 'collective spirit" rather steers debtors into the direction of non-payment. It also influenced the additional increase in debt if the client was in default for a relatively longer time. Also of significance is which institution owns the debt: according to our results, different institutional profiles – and probably different collection strategies – might lead to various results regarding the clients' payments.

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APPENDICES

Appendix Table 1: The most important descriptive statistics of variables applied in the model

Variable name	Variable	Mean	Standard deviation	Minimum	Maximum
d_notdecreased	0 = debt decreased, 1 = debt increased or stagnated	0.67	-	0.00	1.00
d_home_equity	0 = housing loan, 1 = home equity loan	0.55	-	0.00	1.00
d_terminated	0 = valid contract, 1 = terminated contract	0.36	-	0.00	1.00
npl_0_30	1 = below 30 days delinquency or performing	0.31	-	0.00	1.00
npl_30_90	1 = 31 - 90 days delinquency	0.05	-	0.00	1.00
npl_90_180	1 = 91 - 180 days delinquency	0.05	-	0.00	1.00
npl_180_360	1 = 181 - 360 days delinquency	0.06	-	0.00	1.00
npl_360_720	1 = 360 - 720 days delinquency	0.10	-	0.00	1.00
npl_720	1 = over 720 days delinquency	0.43	-	0.00	1.00
social_capital	settlement-level social capital - principal component	0.84	1.40	-3.03	5.12
NPL_debtor_rate	ratio of NPL debtors among the voter population of the settlement	0.03	0.01	0.00	0.10
d_restructured	1 = the contract has been restructured	0.49	-	0.00	1.00
debt_to_borrowed	amount of debt in January 2014 compared to the borrowed credit amount	1.34	0.46	0.00	3.20
d_has_income	0 = no declared taxable income in 2014, 1 = has declared taxable income in 2014	0.67	-	0.00	1.00
income	declared taxable (personal income tax) income of the debtor and co-debtor (if any) in 2014	1,582,600	1,842,172	0.00	9,783,852
ln_income	logarithm of income	9.61	6.77	0.00	16.10
ltv	loan-to-value	81.18	61.12	0.00	318.78
d_ltv_100	0 = LTV below 100, 1 = LTV over 100	0.32	-	0.00	1.00
price_change	change in average square metre prices in the debtor's settlement between 2008 and 2014	-22.78	13.71	-59.15	34.31
job_seekers	proportion of job seekers in the settlement	0.30	0.12	0.00	1.27
independant	number of independants	0.90	1.11	0.00	12.00

Source: Own calculation.

Appendix Table 2: Correlations between model variables

	d_notdecreased	d_home_equity	d_terminated	npl_0_30	npl_30_90	npl_90_180	npl_180_360	npl_360_720	npl_720	social_capital	NPL_debtor_rate	d_restructured	debt_to_borrowed	d_has_income	ln_income	ltv	d_ltv_100	price_change	job_seekers	independant
d_notdecreased	1.00																			
d_home_equity	0.00	1.00																		
d_terminated	0.32	-0.09	1.00																	
npl_0_30	-0.39	0.02	**-0.46**	1.00																
npl_30_90	-0.18	0.01	-0.17	-0.17	1.00															
npl_90_180	-0.13	0.01	-0.16	-0.17	-0.06	1.00														
npl_180_360	-0.01	0.02	-0.15	-0.19	-0.07	-0.07	1.00													
npl_360_720	0.17	0.05	-0.06	-0.23	-0.08	-0.08	-0.10	1.00												
npl_720	**0.41**	-0.07	**0.72**	**-0.55**	-0.20	-0.20	-0.22	-0.28	1.00											
social_capital	-0.06	-0.03	-0.10	0.10	0.01	0.00	0.00	0.01	-0.11	1.00										
NPL_debtor_rate	0.05	0.01	0.05	-0.06	-0.02	-0.01	-0.01	0.00	0.07	-0.38	1.00									
d_restructured	-0.33	0.10	**-0.54**	**0.54**	0.15	0.01	-0.02	-0.06	**-0.54**	0.10	-0.04	1.00								
debt_to_borrowed	0.26	0.06	0.22	-0.25	-0.05	-0.03	-0.01	-0.02	0.30	-0.05	0.02	-0.17	1.00							
d_has_income	-0.05	0.00	-0.07	0.08	0.01	0.01	0.00	-0.01	-0.08	-0.01	0.00	0.07	-0.02	1.00						
ln_income	-0.08	-0.01	-0.10	0.11	0.02	0.01	0.00	-0.01	-0.11	0.01	0.00	0.09	-0.03	**0.98**	1.00					
ltv	0.29	-0.12	0.26	-0.26	-0.06	-0.05	-0.02	0.01	0.31	-0.05	0.03	-0.17	**0.55**	-0.02	-0.03	1.00				
d_ltv_100	0.26	-0.11	0.23	-0.24	-0.06	-0.05	-0.01	0.02	0.27	-0.03	0.02	-0.15	**0.45**	-0.02	-0.02	**0.81**	1.00			
price_change	-0.04	-0.01	-0.05	0.05	0.01	0.01	0.01	0.00	-0.06	0.34	-0.33	0.05	-0.03	-0.01	0.00	-0.06	-0.05	1.00		
job_seekers	-0.02	-0.02	-0.04	0.04	0.00	0.00	0.00	0.01	-0.04	0.33	0.00	0.04	-0.03	-0.01	0.00	-0.01	0.00	0.10	1.00	
independant	0.01	-0.12	0.00	-0.01	0.01	0.01	0.00	0.01	-0.01	-0.09	0.03	-0.01	0.00	0.12	0.15	0.02	0.01	-0.03	-0.04	1.00

Note: The correlations greater than 0.4 and less than −0.4 are highlighted. Source: Own calculation.

Appendix Table 3: Multicollinearity among the variables used in the analysis

Variable name	Variable	Variance Inflation Factor
d_home_equity	0 = housing loan, 1 = home equity loan	1.14
d_terminated	0 = valid contract, 1 = terminated contract	3.10
npl_0_30	1 = below 30 days delinquency or performing	1.18
npl_90_180	1 = 91 - 180 days delinquency	1.27
npl_180_360	1 = 181 - 360 days delinquency	1.35
npl_360_720	1 = 360 - 720 days delinquency	1.58
npl_720	1 = over 720 days delinquency	3.94
social_capital	settlement-level social capital - principal component	1.46
NPL_debtor_rate	ratio of NPL debtors among the voter population of the settlement	1.26
bank 1	client of Bank 1	2.02
bank 2	client of Bank 2	2.37
bank 3	client of Bank 3	2.06
bank 4	client of Bank 4	2.79
bank 5	client of Bank 5	2.50
bank 6	client of Bank 6	1.48

Variable name	Variable	Variance Inflation Factor
bank 7	client of Bank 7	1.09
bank 8	client of Bank 8	1.84
bank 9	client of Bank 9	3.89
bank 10	client of Bank 10	2.18
bank 11	client of Bank 11	2.12
bank 12	client of Bank 12	3.09
d_restructured	1 = the contract has been restructured	2.14
debt_to_borrowed	amount of debt in January 2014 compared to the borrowed credit amount	1.72
d_has_income	0 = no declared taxable income in 2014, 1 = has declared taxable income in 2014	64.00
ln_income	logarithm of income	64.72
ltv	loan-to-value	3.52
d_ltv_100	0 = LTV below 100, 1 = LTV over 100	2.96
price_change	change in average square metre prices in the debtor's settlement between 2008 and 2014	1.20
job_seekers	proportion of job seekers in the settlement	1.15

Note: Multicollinearity is high if the Variance Inflation Factor is higher than 10, i.e. a variable is explained by the other independent variables by at least 90 per cent.

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THE HUNGARIAN "BIG SHORT"
THE RATIONAL AND IRRATIONAL FACTORS OF FOREIGN DENOMINATED LENDING

This paper investigates the financial story that facilitated the spread of foreign denominated loans, the failure of the uncovered interest rate parity, in the Hungarian market of the 2000s. As presented by the study, under the assumption of stationary price changes, foreign currency loans outperformed the loans denominated in forint, even for more risk-averse decision-makers; therefore, taking a foreign currency loan could be a rational choice. The structural changes following the crisis of 2008 have caused the cost of foreign denominated loans to become higher than that of HUF loans. However, several behavioural effects exacerbated the subjective detection of the suffered losses. The analysis points out that foreign exchange loans might be an adequate financing alternative for the corporate sector, which is able to assess the risks. However, the retail foreign currency lending encouraged individual borrowers to take unknown risks, the consequences of which imposed a huge burden on the entire society. Under such market conditions, regulation is required to prevent rational decisions on a micro level from causing a systemic risk.

Introduction

The phenomena of foreign exchange loan and foreign exchange credit lending in Hungary has become known to the general (not professional) public and is now thought to be extremely harmful, mostly due to the individual and society shocks caused by residential mortgage loans.

The financial literature calls this phenomena "dollarization"; it is when, in a given country, the currency of another country is accepted as a payment instrument in certain transactions instead of the payment being made in full or partially in the national currency. The most common reason for the replacement of the national currency in this manner is the unstable economic situation and weak central governance. Therefore, we generally find an example of dollarization in developing countries. The denomination comes from the working practice of Latin American countries, where, following the collapse of the so-called "soft-pegging" exchange rate system tied to dollars in order to reinstate financial trust, the national currency was replaced by US dollar.[1] The replacement currency, however, may not exclusively be USD and can be any other financially accepted stable currency.[2]

With financial dollarization, we understand the presence of deposits and loans in foreign currency in the given economy. It is not necessarily paired with the dollarization of real transactions and the settlement of other assets or wages in foreign currency.

The benefit of financial dollarization is that it prevents the capital flight of savings, and the growing supply on the credit side contributes to the growth of the economy. Its substantial disadvantage, however, is that the impact of the monetary policy tools shrinks, and the consequently created foreign exchange rate risk positions render the country more vulnerable in a possible crisis.

The theories serving as explanations for the phenomena can fundamentally be classified into three groups according to *Ize* and *Levy Yeyati*. The portfolio selection explanations focus on

1 ROCHON and VERNENGO, 2003

2 RENNHACK and NOZAKI, 2006

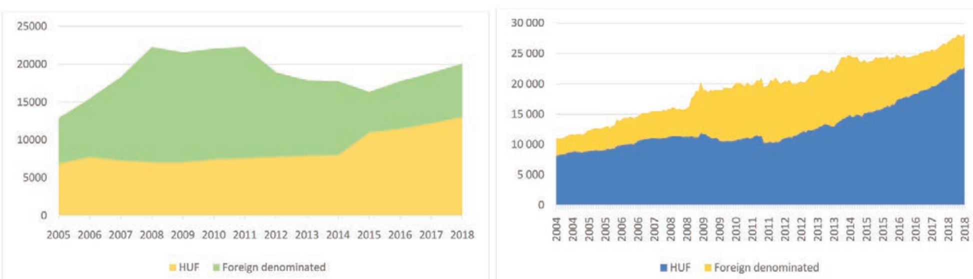
the diversification impact of the assets and resources denominated in foreign currency, and the credit risk explanations examine the non-performing risk of assets defined in various foreign currencies; the third group of theories traces financial dollarization back to the imperfections of the domestic economy, financial markets, and regulatory environment. [3] *Ize* embeds the above explanations into a single model, where the risk-averse, variance-minimizing attitude of the investors – fundamentally households – is opposed to risk-neutral companies, which optimize their credit borrowing by minimizing the credit risk costs.[4] In this model, the foreign exchange rate and the interest rates are specified based on market demand and supply, and an internal balance is created, which reflects the creditors' and borrowers' optimal foreign exchange portfolio.

Basso et al., contrary to the above, found a negative correlation based on the information of 22 eastern Central European (including Hungary) and Asian countries regarding the share of loans and deposits in foreign currency. They establish that, in addition to the substantial interest rate difference, the increasing share of foreign-owned banks increases the credit dollarization, especially when there is large competition between the banks to gain market share.[5] The study of *Luca* and *Petrova* highlights the role of bank incentives by examining the demand side (company-specific) and supply side (bank-specific) factors; according to these, one of the key drivers of foreign exchange lending is the foreign-owned banks' asset to resource conformity.[6]

With the transition to market economy in the Hungarian market, a similar process took place starting from the 1990s. With the high inflation environment and an exchange rate system that seemed reliable, along with available credit resources due to the appearance of foreign-owned banks, a considerable part of the loans was taken by the market participants, not in forints but in foreign currencies, German marks (later in euros), and dollars.

In the beginning of the 2000s, a substantial part of both the corporate sector and the public debt was denominated in foreign currency. This ratio progressively increased through the course of the decade, as can be seen in Figure 1.

Figure 1: The credit volume of the corporate sector (left side) and the structure of the public debt (right side) in billion HUF



Source: MNB, ÁKK

3 IZE, 2006, LEVY YEYATI, 2006

4 IZE, 2006

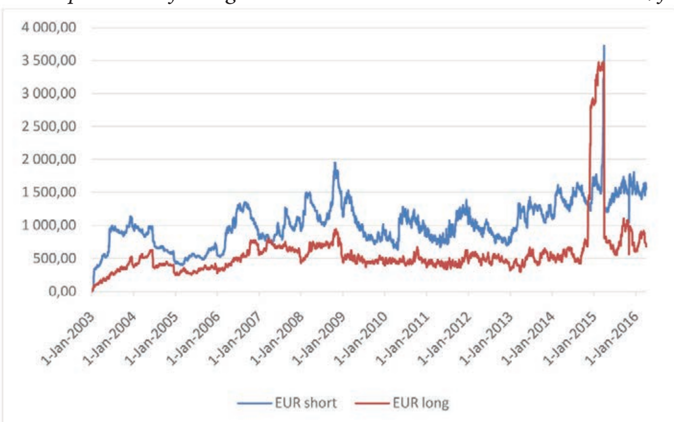
5 BASSO et al., 2007

6 LUCA and PETROVA, 2003

The apparent arbitrage opportunity, due to the significant interest rate difference and the stable exchange rate, was harnessed not only by the foreign currency loan borrowers, but the majority of the forward FX-stocks – concluded either with hedging or speculation purposes – were short foreign currency positions.

Figure 2 shows that the forward sales (EUR short positions) were roughly double the volume of forward purchases (EUR long positions). The fluctuation of forward positions was caused mainly by the changes of the foreign exchange rate and the foreign exchange rate volatility[7] and not the development of foreign trade. The expectation dominated in this market as well, based on which the high interest rate difference, apart from the exchange rate stability, can (almost) be achieved without any risk.

Figure 2: Forward FX-positions of Hungarian banks with non-bank resident clients, forints in billions



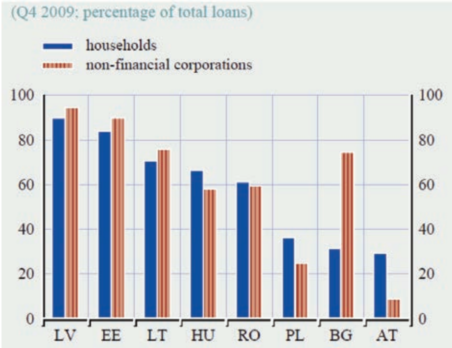
Source: MNB

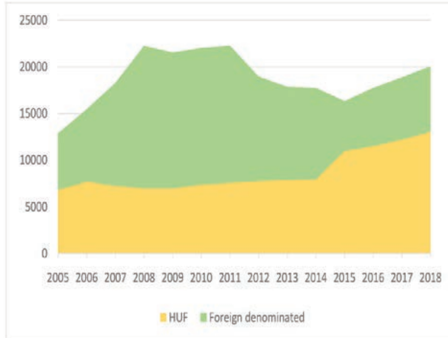
In this environment, where all the market players placed their bets on the strong forint, it seemed obvious to provide the population with the opportunity to access "cheap" foreign exchange credits after phasing out the subsidized housing loans.[8] Several studies addressed the accumulation process of foreign denominated loans in Central Eastern Europe, including Hungary, and the contributing economic and political environment.[9]

Retail foreign exchange lending is not a Hungarian specialty; similar processes also took place in other Central Eastern European countries as well.

7 DÖMÖTÖR and KOVÁCS, 2017
8 BODZÁSI, 2015
9 BROWN and DE HAAS, 2012, KIRÁLY and BANAI, 2013, KIRÁLY and SIMONOVITS, 2017

Figure 3: The share of foreign exchange loans in the Eastern European region compared to the entire credit volume (2009) (left) and the Hungarian retail credit volume for 2005 to 2018 in billion HUF (right)





Source: MNB, ECB, Financial Stability Review, June 2010

Figure 3 shows that the share of foreign exchange credits was most substantial in the Baltic states. Besides these, a considerable part of the retail credits were foreign exchange credits in Romania, Poland, and Bulgaria as well. By 2008, about two-thirds of the Hungarian retail (primarily mortgage) loans were denominated in foreign exchange.

While analysing the macroeconomic consequences of foreign exchange loans, *Brzoza* et al. found that, although they decrease the transmission impact of monetary policy, it has a positive impact on the macro-prudential policy. Therefore, the foreign exchange loans increase prosperity if the interest rate shocks are decisive in the economy; however, they reduce prosperity if the foreign exchange rate shocks are dominating. They also highlight that the policy-limiting foreign exchange loans leads to short-term economic regression.[10]

Considering the above, it is clear that neither the population enjoying cheap credits nor the banks profiting from the boom in lending, nor the government keeping short-term economic growth in sight were interested in reducing foreign exchange lending and the consequently created foreign exchange exposure.

The consequences of retail foreign exchange lending are well known by now. The weakening foreign exchange rate due to the economic crisis that started in 2008 made it clear for the majority of credit borrowers as to what kind of risk is concomitant with the option of cheaper credit. Due to the exchange rate increase, the instalments of foreign exchange loans grew, which was accompanied by the weakening labour demand due to the crisis. The financial distresses of debtors also impacted the banks negatively, the share of non-performing loans increased, and the deteriorating bank credit portfolios caused substantial losses to the lending banks. Further, from a macroeconomic perspective, the financing of the huge, open foreign exchange position entailed an increasing risk, and the establishment of the sovereign crisis jeopardized the Hungarian financial system.

10 BRZOZA et al., 2017

The settlement of the retail foreign exchange credit problem began in 2010 by prohibiting the retail mortgage loans in foreign currency; then, after numerous proposals[11], it ended by the conversion of the entire portfolio into forints through several steps.

This study examines the foreign exchange loan as a financial product from the perspective of a rational decision-maker, which may be an individual or a company. By analysing the market of the 2000s, I will demonstrate how a foreign exchange loan seemed to be a better alternative than a forint loan and how much more expensive it subsequently proved to be as compared to a similar HUF loan. I conclude that the depreciation of the forint increased the falsely-timed foreign exchange credit costs over the costs of HUF loans. This difference is moderate in the case of EUR loans but substantial in the case of credits in Swiss francs. The credit borrowers' subjective sense of loss was enhanced by the fact that they did not consider the costs of the HUF loan as a reference point for their credit borrowing.

Several other factors also contributed to the difficulties faced by foreign exchange credit debtors and the escalation of the problem, including the unilateral interest rate changing option of the banks, the obvious informational asymmetry, bad incentives, and the reduction of labour demand due to the crisis. However, their examination is not the subject of this analysis.

1. The "big short"of foreign exchange loans

In the beginning of the 2000s, investors in the Hungarian market – including companies, the state, and foreign investors as well – were all counting on the exchange rate of forints staying stable despite the high interest rate difference. This phenomenon is the failure of the uncovered interest rate parity, in which case the expected value of the forward positions will be different from zero.

1. 1. Covered and uncovered interest rate parity

The covered interest rate parity describes the relationship between the spot and the forward exchange rates. Accordingly, the exchange rate that can be fixed now and that refers to the future – the forward exchange rate – is nothing else but the spot rate increased by the difference between two interest rates.

$$F = S_0 \frac{(1+r_{domestic})^t}{(1+r_{foreign})^t} \tag{1}$$

Where,
S_0 is the spot rate;
F is the forward rate with given maturity;
t is the time to expiry, expressed in years;
$r_{domestic}$ is the domestic spot risk-free interest rate for the period t;
$r_{foreign}$ is the foreign spot risk-free interest rate for the period t.

11 BERLINGER and WALTER, 2013, 2014

The above mechanism of forward pricing is based on consistent (arbitrage-free) pricing; neither the investor preferences nor the risk attitude, nor the expected yield of the underlying product have a role. The relationship in Equation 1 is always met (assuming a liquid spot and forward foreign exchange and interest rate market(s)), unless that the opportunity of arbitrage comes up, which will be utilized by the market players.[12]

If the foreign interest rate is higher than that of the domestic, the forward exchange rate will be lower than the spot rate. Conversely – which was characteristic for the Hungarian market that has also been analysed by us – the forward exchange rate is higher than the spot one.

It is worth mentioning that due to the covered interest rate parity, it makes no difference in which currency we invest our money; if we agree to convert it back into the national currency by conluding a forward transaction, the profit gained or lost on the interest rate will be offset by the exchange rate profit or loss. In case the interest rate of the foreign currency is higher than that of the domestic, despite receiving a higher interest rate on our deposit, the forward exchange rate is lower than the spot rate, i.e. we receive less national currency per unit of foreign currency at the end.

The same applies to borrowing credit at a lower interest rate in foreign currency, if we prefer to eliminate the exchange rate risk with a forward transaction, the forward rate that can be fixed now will be higher. Thus, the loss of the exchange rate will exactly offset the interest rate profit.

Based on the above, it is evident that the suggestions, according to which it would have been better for the foreign currency credit debtors to hedge their foreign exchange risk by forward transactions, do not make much sense, as their credit would have been a HUF loan with higher interest rates in this case. The reason for choosing to take foreign currency loan is precisely the lower interest rate cost. In case the credit borrower takes a loan in foreign currency, he creates an open position, as he does not know the exchange rate he will be able to buy the foreign currency in order to repay the loan upon maturity.

The spot foreign exchange rate in the future is a probability variable. The question is, what can we say about its expected value? Does it equal today's forward exchange rate? Is the following equation valid?

$$E(S_t) = S_0 \frac{(1+r_{domestic})^t}{(1+r_{foreign})^t} (= F) \tag{2}$$

Where, *E* is the expected value, and S_t stands for the spot rate in time *t*.

Equation 2 describes the uncovered interest rate parity, the relation between the expected future exchange rate, and the current interest rates. Accordingly, the spot FX-rate's (which is a probability variable) expected value equals to today's forward rate, and the exchange rate is expected to change according to the interest rate difference between the two currencies. The currency with the higher interest rate is expected to depreciate against the other. Consequently, in case the uncovered interest rate parity holds, it does not matter as to which foreign exchange we take out a loan in, or place a deposit; what we gain (or lose) on the interest rate will be exactly equal to what we lose (or gain) on the exchange rate. An important

[12] The definition of forward exchange rate and the utilization of the opportunity of arbitrage upon wrong pricing is part of all fundamental financial textbooks, for more detail see SZÁZ, 2009, or HULL, 2008.

difference, however, compared to the above relationship – the covered interest rate parity, is that entering into a forward transaction fixes the exchange rate at maturity. however, the uncovered interest rate parity determines the expected value of the exchange rate at maturity.

In case the uncovered interest rate parity holds, it is not really worth speculating with forward transactions, since the result of the transaction will be randomly distributed around zero. According to the modern portfolio theory,[13] the expected spot FX-rate will equal to the forward exchange rate if the systematic risk of the given asset (correlation with the market portfolio) is zero. The risk premium on the foreign exchange market is called country risk premium (CRP), and Equation 2 is modified as follows:

$$E(S_t) = F\frac{1}{(1+CRP)^t} \tag{3}$$

In case of a positive country risk premium, the expected future exchange rate will be lower than the forward rate, since the investors will request positive risk premium for riskier assets and invest in riskier currencies only if the expected change of the exchange rate is lower than the interest rate difference.

1. 2. Decomposition of theforeign exchange loan

The foreign exchange loan is nothing else but a HUF loan plus forward sales of the foreign currency. The borrower of the foreign exchange loan – assuming that he/she has no income in foreign currency – is undertaking a speculative position, obviously with the aim of lowering HUF loan costs by the profit of the forward position.

Let's examine the above statement through a simple example. We will assume that a credit borrower would like to take credit out for one period (1 year) and has to decide which currency to take the debt in (foreign or domestic currency). There are credit markets in both currencies, and the interest rate to be paid in the domestic currency is $r_{domestic}$ and in foreign currency is $r_{foreign}$; the spot rate is S_0, and the spot rate in one year is S_1. Consider the exchange rate as the price of one unit of foreign currency, and the credit to be taken out is one unit of foreign currency. The current payment – the actual credit to be taken in both cases – is $S_{0.}$ This is the credit amount in the domestic currency. For the credit in foreign currency, we convert one unit of foreign currency by the spot rate, so we acquire S_0 domestic currency.

The cash flow of the two constructions are identical initially, unlike that at the repayment. We know the amount to be paid in domestic currency as the credit taken and the interest rates are known. In case of a creditin foreign currency, however, the redemption amount denominated in domestic currency depends on the spot rate at repayment. The cash flows are summarized in Table 1.

	$t = 0$	$t = 1$
National currency	S_0	$-S_0(1+r_{domestic})$
Foreign currency	S_0	$-S_1(1+r_{foreign})$

Table 1: The cash flows of one-period credits in domestic and foreign currency

[13] ELTON et al., 2009

You can see that at maturity *(t = 1)* the payment difference, on one hand, depends on the difference between the two interest rates (this is known in advance). It also depends on the difference between the spot and maturity rates (this is not known in advance). By subtracting the two from each other, we get the following Equation:

$$-S_1(1+r_{foreign})+S_0(1+r_{domestic})=(1+r_{foreign})\left(S_0\frac{1+r_{domestic}}{1+r_{foreign}}-S_1\right) \tag{4}$$

It means that the difference between the two types of credit redemptions equals the value of the short forward position of $(1+r_{foreign})$ unit foreign currency. Thus, the one-year forward sales position's value at maturity *(f)* depends on the spot rate at maturity, i.e.

$$f=F-S_1 \tag{5}$$

As a consequence of the above, the amounts to be paid for the foreign currency loan and the HUF denominated loan are identical if the spot rate at maturity (in this case, in one year) is equal to the forward rate of the credit borrowing date.

As the borrower of the foreign exchange credit has a short forward position, he will suffer a loss as compared to the borrower of the HUF loan, if the spot rate increases at a rate exceeding the interest rate difference. It is important to note that the foreign exchange credit debtor was better off than the HUF credit debtor, as long as the increasing exchange rate stayed under the forward exchange rate ($S_1<F$).

The real credit constructions were certainly not one-year loans. The above concept can however be interpreted similarly in case of a variable (continuously decreasing) credit amount and multi-period loans hedged by cross currency swap.[14]

The foreign exchange lending was nothing but the "shorting" of the foreign currency on a national level.

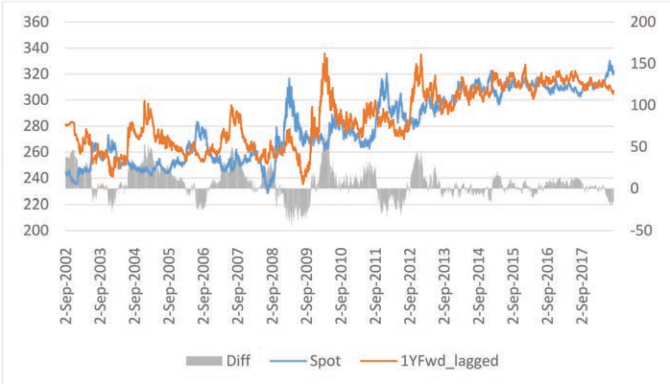
In the followings, I will examine what kind of risk the foreign exchange loan meant for a rational decision-maker who could realistically assess the risks and what kind of risk attitude was required for someone to choose to take the foreign exchange loan.

2. Empirical study

The uncovered interest rate parity holds if the spot rate at maturity is expected to match the forward exchange rate. The EUR/HUF and CHF/HUF market development is demonstrated by Figures 4 and 5 from 2001, the date of the liberalization of the forint.

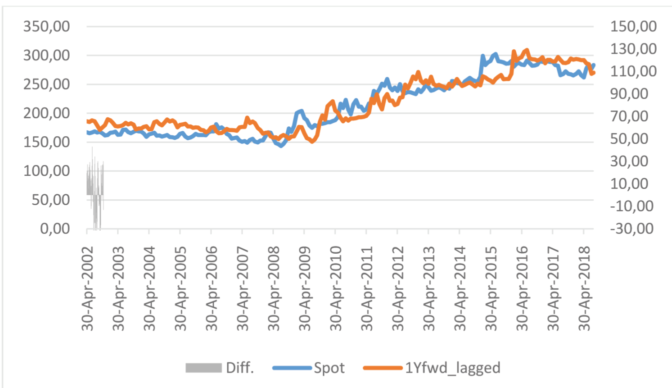
[14] KIRÁLY and SIMONOVITS, 2017

Figure 4: The EUR/HUF spot rate and the lagged one year forward rate between 2002–2018 (left axis) and the difference of the two (right axis)



Source: Bloomberg

Figure 5: The CHF/HUF spot rate and the lagged one year forward rate between 2002–2018 (left axis) and the difference of the two (right axis)



Source: Bloomberg

The dark line shows the spot rate, and the light one shows the one year forward rate one year before, i.e. the exchange rate of the just maturing transactions. In case the uncovered interest rate parity holds, the size of the grey areas that show the difference of the two, under and above the zero axis, should be equal.

It can be seenin both figures that, until 2008, the positive difference is denominated, and the forward exchange rate for the majority of the period exceeded the spot rate at maturity. During this period, there were some periods when the one-year foreign exchange loan proved to be more expensive than the HUF loan. In a longer credit construction, however, the foreign exchange loan debtors were obviously better off.

After 2008, the foreign currency rate that was considered stable before substantially weakened as a consequence of which the payment obligations of the foreign currency loans rose over the burdens of the HUF loan.

I will investigate two questions below. On one hand, I will examine how a rational credit borrower in the summer of 2008, directly before the crisis, considered the risks of EUR and CHF loans. On the other hand, I will analyse how much more expensive a 10-year foreign currency loans taken out in 2008 was for the credit borrower as compared to an HUF loan. Although in 2015, the retail foreign currency credits were converted into forints, nearly half of the corporate loans are still foreign denominated (see Figure 1).

2. 1. Risk of Foreign denominated loans as of 2008

According to the efficient market hypothesis,[15] the prices of products traded on the financial markets reflect all available information; therefore, their change is due to random, new incoming information. Hence, the price movement has *Markov* nature and the geometric Brownian motion (GBM) is used for describing the price development.

Presuming the development of the foreign exchange rate according to the GBM, the annual logarithmic return is a normally distributed random variable, the parameters of which can be estimated from the returns of the previous periods as a random sample from the underlying distribution.

In case an investor had modelled the exchange rates at the end of August 2008, based on the EUR/HUF and CHF/HUF prices of the previous five years, one could observe that the HUF was expected to strengthen against the EUR by 1.3% annually and against the CHF by 2.26% annually. Moreover, the exchange rate volatility would have been 8–9% on an annual level. The one- and ten-year foreign interest rates were 3–5% lower on an annual basis than the HUF rates.[16] Based on the model, therefore, the credit borrower could expect that despite the substantial interest rate difference, not only would the HUF not weaken according to the uncovered interest rate parity but also would strengthen, making the foreign exchange loan even cheaper.

The *Markowitz* portfolio theory (1952) presumes that an individual decision-maker's utility function depends on the expected return *(E(r))* and its variance (σ^2) .

$$U = E(r) - 0.5A\sigma^2 \tag{6}$$

Where, is the risk aversion coefficient, which measures how sensitive the investor is towards the risk measured by the variance. Calculating the level of risk aversion above which the decision-maker would rather choose the expectedly more expensive but risk-free credit borrowing alternative, the received values are 13.82 and 18.80. As a comparison, the long-term average risk premium of the American equity market (approx. 8%) with 20% volatility corresponds to a 3.6 risk aversion coefficient.

15 MALKIEL and FAMA, 1970

16 Based on the yields of government bonds.

The data is summarized in Table 2.

	Exchange rate (Compared to the HUF)		Interest rate difference (Compared to the HUF)		Rate of risk rejection
	Drift	Volatility	1-year	10-year	A
EUR	–1.30%	8.12%	3.12%	3.25%	13.82
CHF	–2.26%	8.64%	5.26%	4.75%	18.80

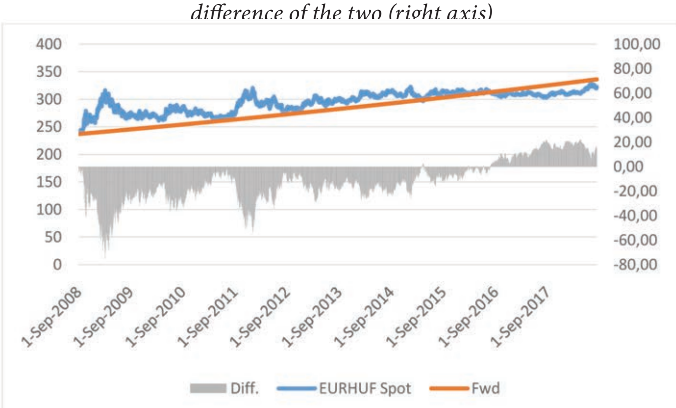
Table 2: Exchange rate modelling based on market data at the end of August 2008
Source: Bloomberg, ÁKK, ECB, SNB

The analysis assumes that the returns are stationary, i.e. the parameters of the underlying distribution are stable.

2. 2. The cost of foreign exchange loan between 2008 and 2018

The crisis led to a structural change in the financial markets, and the model parameters changed substantially. Regarding the EUR/HUF exchange rate relation, based on the figures of the ten years between 2008 and 2018, the rate of growth for the exchange rate increased to 3.5% per year. It was only slightly higher than the difference of the 10-year interest rate levels in 2008.

Figure 6: The EUR/HUF spot rate and the forward rate fixed in August 2008 (left axis) and the difference of the two (right axis)



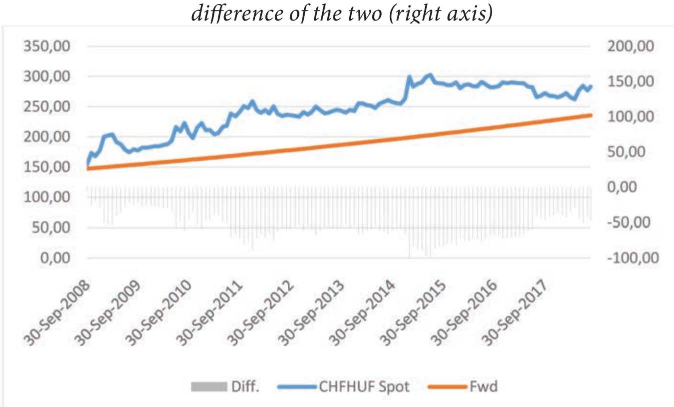
Source: Bloomberg

In Figure 6, the light line indicates the forward exchange rates that could have been fixed at the end of August 2008, while the dark line indicates the actual spot rates. The grey area is the deviation from the uncovered interest rate parity. Compared to Figure 4 that indicated the difference from uncovered interest rate parity for one year, Figure 6 compares the spot rate movement and the forward rate fixed in August 2008 for the given day. In case of a 10-year loan, the actual cost was determined by the repayment schedule. If we examine an annuity construction, the costs of EUR loans taken in August 2008 exceeded the costs of the HUF loan by one percentage point.

This raises a question: if with the worst scheduling – with credit taken out by the lowest foreign currency rate followed by a continuous exchange rate increase – the foreign exchange loan only proved to be one percentage point more expensive than the HUF loan, why do so many people talk about a national catastrophe occurring?

By 2008, the majority of the retail foreign exchange loans were in Swiss francs denominated. [17] The exchange rate of the Swiss franc, as compared to the HUF, went through an even more drastic change. Figure 7 shows that the debt in Swiss francs had a considerable exchange rate loss throughout the entire period.

Figure 7: The CHF/HUF spot rate and the forward rate fixed in August 2008 (left axis) and the difference of the two (right axis)



Source: Bloomberg

The annual growth rate of the Swiss franc exchange rate between 2008 and 2018 was about 7.5%. To pay the monthly instalments for ten years of a loan taken out in 2008, the CHF had to be purchased at an average 39% higher foreign exchange rate than what the forward exchange rate was in 2008. Therefore, the interest rate of a 10-year annuity payment CHF credit exceeded the interest rate of a similar HUF loan by total 7.74 percentage points ex-post.

3. Behavioural effects

When examining the decision-making situation of a credit borrower above, I have assumed that the decision-maker was perfectly informed, was aware of the possible outcomes of his decision, and was also rational. Rationality in economics means that one's choices correspond to the maximization of his expected utility, i.e. there exists a utility function, according to which the decisions are consistent.[18] Based on the above, the analysis of the foreign exchange

[17] KOLOZSI et al., 2015

[18] BERLINGER and VÁRADI, 2015

loans concluded that taking loan in foreign currency must have been a rational choice for a credit borrower by the given, not ultimately, high risk aversion level.

Kahneman and *Tversky* were among the firsts to examine and describe those decision anomalies, which were typical for most individual decision-makers and cannot be aligned with the theory of expected utility.[19] In conjunction with the foreign exchange loans, two well-known behavioural effects should be highlighted: framing and the change of the risk attitude.

Framing describes the phenomena of how a decision-maker is influenced by the formulation of a scenario. The decision depends on how the given situation is presented to him/her (when choosing from various therapies, it matters whether we show the survival or the mortality rate, although both contain the same information).

Most likely, less people would have taken credit in a foreign currency if the contract included that, in addition to the HUF loan, one must make a series of forward transactions – although, basically, this is what they signed.

One manifestation of framing is that, in decision-making situations, we are inclined to adjust our future vision to an externally provided or imaginary reference point.[20] In case of foreign exchange credits, the actual exchange rate appeared to be an anchor in the decisions. Even though based on the exchange rate volatility, an unfavourable outcome would have also been probable, not only the retail credit borrowers but also the professional lenders did not realistically consider the substantial changing of the exchange rate. The overly optimistic expectations regarding credit costs were reinforced by the methodology of the Annual Percentage Rate of Charge (APRC) calculation, based on which the otherwise uncertain future conversion rate has to be replaced by the spot rate.[21]

The same effect appears in sensing the suffered losses. In the previous chapter, I presented that a 10-year EUR loan taken out before the crisis proved to be by an annual one percentage point more expensive, while the CHF loan was subsequently 7.74 percentage points more expensive than the HUF loan. However, the credit borrowers did not compare the actual costs to the HUF loan, but they took the 3 to 5 percentage points more favourable interest rates as a reference point.

The subjective risk-detection also played an important role in credit borrowing decisions. *Kahneman* and *Tversky* demonstrate how the attitude toward risk, on one hand, depends on whether we talk about profit or loss and, on the other hand, on how likely these profits or losses are to occur.[22] In general, risk-aversion is typical when assessing profits with high probability and losses with low probability, but the decision-maker becomes a risk-seeker when he/she has to decide about losses with high probability and profits with low probability.

The risk assessment of foreign exchange credit was distorted by the social impact, based on which decision-makers become less risk averse during group decision-making.[23] The

[19] KAHNEMAN and TVERSKY, 1979, 1992

[20] JÁKI, 2013a, 2013b.

[21] BERLINGER, 2017

[22] KAHNEMAN and TVERSKY, 1979, 1992

[23] BERLINGER and VÁRADI, 2015

spread of foreign exchange credits therefore strengthened the underestimation of related risks, and people took mostly unseen risks in return for the lower foreign exchange interest rates that were taken as a reference point.

4. Conclusions

The severe individual and social impacts of retail foreign exchange lending make many people believe that this form of financing is clearly damaging. However, the fact that nearly half of the corporate loans today are foreign denominated loans contradicts the abovementioned point.

The study has demonstrated that EUR denominatedloan borrowed at even the worst timing only entailed moderate extra costs as compared to the HUF loan. The sudden losses experienced in the CHF loans, however, generated substantial extra costs even compared to the cost of HUF loans. This was further worsened by the fact that credit borrowers considered the lower foreign exchange interest rates as a reference point, compared to which the sensed interest rate surcharge of foreign exchange loans corresponded to 12–13% on an annual basis.

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RETAIL FOREIGN CURRENCY LENDING AND THE ECONOMIC CRISIS – JUDICIAL EXPERIENCES

Introduction

Foreign currency lending might be the most notable story of 21st century Hungary. It impacted a substantial part of the population directly or indirectly, and its consequences are still manifest in our daily lives. Therefore, it is practical and necessary to thoroughly investigate those reasons and processes, which led to the appearance and penetration of this special banking credit product, as well as those impacts and consequences triggered by foreign currency lending.

The study examines the situation of the flourishing Hungarian foreign currency lending at the time the economic crisis broke out in 2008. We wish to present the impact the crisis had on the stakeholders of this credit lending relationship and, consequently, the types of problems that emerged and proposals for solutions made.

The study fundamentally analyses what happened after the breakout of the crisis from a legal perspective. However, we cannot avoid an investigation into the nature of the foreign currency loan itself and – also considering the reactive nature of science – those conditions of economics, which the legal features of the foreign currency loan and the loan agreement are related.

The study separately addresses the introduction of self-regulating aspirations of financial institutions. Through these, the banks wanted to limit the excessive indebtedness of consumers even before the crisis, and to boost market competition by drafting proposals for legal regulators. At the same time, it is extraordinarily instructive how the legal regulators accepted these aspirations, and to what extent they could integrate the professional knowledge based on practical experience. From the regulating side, the efficiency of the applied legal solutions needs to be examined, on one hand from the aspect of arising problems, and on the other hand by the timely recognition and management of similar future problems.

In addition, the study presents the legal solutions for the remedy of social-economic problems arising due to the crisis (in many cases for their mismanagement), the legislative and judicial practice, as well as the solutions and measures proposed by market stakeholders.

The study does not separately address the specific questions and judicial practice arising in foreign currency loan litigation. Reference to litigation serves only to illustrate, sometimes justify the said legal context.

1. The foreign currency loan

1. 1. The concept of the foreign currency loan

The foreign currency loan is not a concept of our time, it was already known at the end of the 19th century, so its dogma can be considered elaborate.

> *"The lender shall pay the promised loan amount in accordance with the legal provisions regarding the payment of monetary debt. The general rule that applies without any specific stipulation is that the lender shall disburse the promised loan amount, regardless of how its*

amount is established, in the legal currency of the place of payment. If the disbursal was not in this currency, the recalculation shall take place at the exchange rate of the actual payment date. Certainly, there might be an agreement in the legal transaction to have the loan amount paid out either in the denominated currency, or effectively in another currency. In all these cases, the lender shall pay the loan amount in the currency actually nominated for disbursal based on the stipulation. No matter what currency the payment took place in, the lender did not loan out the currency amount in which it was imposed in, but the amount, for the payment of which it paid. So if the lender committed to loan GBP 100, the loan amount was paid out in Zurich, and the exchange rate on the date of payment is 15 Swiss francs per Pound, when the lender paid CGF 1500 to the credit borrower, he did not loan CHF 1500, but GBP 100.[1]"

The lender commits to provide a loan in the specified currency (denominated currency), and the debtor shall repay the specified loan amount (in the same currency and in the same amount).

As a general rule, the loan will be disbursed in the local currency of the place of disbursal, however, it does not influence the obligation of the debtor to pay the loan amount specified in the denominated currency. The debtor and the lender may agree in the contract (considering the disposing regulation regarding the contract) to have the disbursal and/or repayment of the loan – contrary to the general rules – paid in another currency. This however does not influence the obligation of the lender to provide the loan amount in the denominated currency, nor the obligation of the debtor to (regardless of which currency the loan is repaid) pay the specified loan amount in the denominated currency based on the contract.

Tying the debtor's payment obligation to the denominated currency also means that, from the perspective of the construct, the exchange rate fluctuations of the disbursed and paid currency is irrelevant between the date of disbursal and the date of repayment. If the currency of the repayment is appreciated against the denominated currency, the debtor has to pay a nominally smaller amount (less) in the paid currency. On the contrary, if the currency of the repayment is depreciated against the denominated currency, the debtor has to pay a larger amount (more) in the paid currency. In other words: the burden of exchange rate fluctuation, and the exchange rate risk as a consequence of the construct burdens the debtor.

It is also a generally prevailing rule in the construct that the disbursal of the loan amount is usually not in the denominated currency, and the repayment, i.e. redemption of the loan, is not in the denominated currency. This however does not change the contractual obligation of the parties, which is the nature of the contractual obligation of the parties' contract. Due to the disposing nature of the contract, the parties can certainly agree that both the disbursal and the repayment of the loan shall take place in the denominated currency (or any other necessary to achieve the commercial objective related to the contract).

The distinction between a foreign currency loan and a loan denominated in foreign currency has no significance from the aspect of legal assessment of the legal relationship. In case of a foreign currency loan, the lender's payment (disbursal) obligation and the credit borrower's

1 SZLADITS Károly: Hungarian Civil Law. *The extraordinary part of the law of contract.* Budapest, Book publisher of Károly Grill, 1942. 176-177.

payment (redemption) obligation is applicable in the denominated currency as per the contract, whereas in case of a loan denominated in foreign currency, it is denominated in a currency different from the denominated currency.

This difference was presented by the President of the Hungarian Financial Supervisory Authority (hereinafter referred to as: HFSA) to the Curia in its letter dated 31 May 2013.

	Foreign currency loan	**Foreign currency denominated loan**
BANK RESOURCE	in foreign exchange	in foreign exchange
REGISTRATION OF THE LOAN	in foreign exchange	in foreign exchange
DISBURSAL	in foreign exchange	in HUF
Conversion within the bank before disbursal	none	From foreign exchange to HUF
REDEMPTION	in foreign exchange	in foreign exchange
Conversion by the client	From HUF to foreign exchange *	none
Conversion within the bank after redemption	none	From HUF to foreign exchange

** except, if the client has income or savings in foreign currency*[2]

Directive 2014/17/EU of the European Parliament and of the Council on consumer credit agreements related to residential properties, as well as Directive 2008/48/EC and 2013/36/EU and on the amendment of Directive 1093/2010/EU (hereinafter referred to as: Directive) contain provisions regarding the concept of foreign currency loan and the information provided for consumers taking the foreign exchange credit.

According to the Directive (Article 4. 28.) *"The Foreign currency loan: means a credit agreement where the credit is:*

a) denominated in a currency other than that in which the consumer receives the income or holds the assets from which the credit is to be repaid; or

b) denominated in a currency other than that of the Member State in which the consumer is resident."

The Directive enables member countries to bring further provisions regarding the regulation of foreign currency loans, provided they are not backdated [Article 23 paragraph (5)]. The Directive therefore considers the institution of consumer credit provided in foreign exchange to be in tune with European law in the long-term as well, and the question of nullity or unfairness in connection with the contract type does not arise. The Directive

2 https://felugyelet.mnb.hu/data/cms2401714/PSZAF_levele_a_Kuria_reszere.pdf

specifically stipulates the general prohibition of retrospective application of legislation in connection with foreign currency lending.

The law of Hungary also contains a similar provision to the previously described principle-based approach and EU regulation. According to Section 6:45 of the Hungarian Civil Code, per the Terms of payment of monetary debts

(1) *"A monetary debt shall be settled in the legal tender at the place and time of settlement.*
(2) *If the monetary debt is recorded in another currency, it shall be converted at the exchange rate specified by the central bank of the place of settlement in effect at the time of settlement, or failing this, based on the money market rate. If a monetary debt is to be repaid in a foreign currency, and at the time of settlement the debt cannot be repaid in that foreign currency, the monetary debt shall be settled as under Subsection (1)."*

1. 2. Banking approach

During the analysis of foreign currency lending – in addition to the previous legal foundation – we must mention the related operations of banks, and their financial mediating role as well. The fundamental function of a bank is to provide loans from the deposits placed with them. It pays interest on the deposit to the depositor, and collects interest on the loan. The loan interest rate (the difference between the interest rates) covers the bank's expenses and risks, and guarantees profit. Therefore it is an economic axiom, that in the same currency the loan interest rates are higher than the interest rates paid on the resources, i.e. a credit institution is not able to provide a loan (lend) under the level of the interest rates covering its resource costs.

> **Axiom 1:** The loan conditions are not freely formed by the bank, it must consider the deposit (resource) side as well.

An individual (depositor, investor) with temporary surplus cash puts the money where he/she gets the highest interest rate (yield).

> **Axiom 2:** There is market competition regarding the collection of resources, and with the establishment of deposit interest rates the bank takes the yield of other investments (e.g. government securities) into consideration as well. Also, competitors' loan interest rates.

The Hungarian economy (including the Hungarian banking system) has traditionally lacked resources, with fewer deposits than the demand for credit. With the integration of foreign resources, foreign currency lending was already a well-known practice during dualism, and between the First and the Second World War. The Hungarian economy has always lacked capital, and it had fewer resources (savings), than assets (credit). The banks with foreign ownership provided foreign resources for Hungarian developments. They financed the construction of mills, railways, cosmopolitan cities, etc. Market practice was followed by economic and legal theory, and the application of the denominated and paid currency.

> **<u>Axiom 3:</u>** Foreign currency lending is not a new invention, it has been practised in Hungary for 150 years and has been theoretically grounded.

In Hungarian practice, inflation-indexed pricing is also known in the case of other, long-term transactions (e.g. property leasing), when consideration for the service is made contingent on an unforeseeable change in the external conditions independent of the parties.

> **<u>Axiom 4:</u>** Pricing made dependent on an unforeseeable external condition independent of the parties is not unknown today, and it does not make the product "faulty" in itself, hence also not the foreign exchange credit.

Following the year 2002, under the economic and financial market conditions and due to the legal provisions in Hungary of the time, the interest rates of HUF credits (loans) were quite high, adapted to the interest rates of available HUF resources. At the same time, it was possible to obtain foreign currency loan resources on the international financial markets at a fairly low resource cost. In this situation, clients decided on cheaper loans denominated in foreign currency, and the credit institutions serving this demand started to outsource loans denominated in foreign currency as well as foreign exchange credits in an ever-increasing volume.

> **<u>Axiom 5:</u>** The bank needed to provide a foreign currency resource for the low-interest loan, otherwise (in case of a HUF resource with high interest level) it would have suffered a loss.

The foreign currency resource financing the foreign exchange credits can be (i) the foreign currency deposit of clients (ii) the foreign currency loan borrowed from the market, i.e. the institutions (and also the equal amount of foreign currency policy issue), as well as (iii) the so-called foreign currency swap, when the bank receives foreign currency for a certain period in exchange for forints. The common feature of these foreign exchange resources is that upon their maturity dates the bank has to "return" a certain amount of foreign exchange to the depositors, the institutional lenders or the partner with whom they signed a foreign exchange swap transaction according to the construct. Since the foreign exchange amount is given, the weaker the HUF is, the higher the amount the bank has to covert to foreign exchange upon repayment, thus the more it costs to repay the debt.

> **<u>Axiom 6:</u>** The bank owes its own lenders the same way as the client borrowing the foreign exchange credit owes the bank, so if the exchange rate is weaker, they have to pay a higher amount back in forints.

It is a unique feature belonging to the prudent operations of banks, that in case of providing a foreign currency or foreign currency denominated credit, the bank has to procure foreign currency financing in an equal amount. Should the bank not do so, it would have an open position, i.e. it would assume a foreign currency exchange rate risk. Risk-taking of this type is monitored and tracked by the supervisory entities (MNB, Hungarian Financial Supervisory

Authority) on a daily basis. In addition, the banks have to ensure funding by strict legal regulations, which should be indicated in its accounting reports.

> **Axiom 7:** The condition, that there is foreign exchange resource behind the foreign currency loan, is certified by the reports of MNB and Hungarian Financial Supervisory Authority and the bank's accounting reports, in addition to the contents of point 5.

In case of a foreign currency loan, the credit resource is available in foreign currency. However, the client needed HUF, so the bank disbursed HUF and this HUF amount appeared on the client's account (simply: the bank purchased and converted the credit amount provided for the client in foreign currency into HUF). Therefore, the loan amount was disbursed on the client's account in HUF and not in foreign currency. When the bank converts the foreign currency that it borrows into forints to be able to disburse HUF to the client, it takes a short-term foreign currency exchange rate risk. If the disbursal in foreign currency would also suit the client, the bank would not take this risk (as in this case the client would convert the foreign currency into HUF on the current foreign exchange rate on the market). With repayment, the situation is exactly the opposite. In order to fulfil the client's payment obligation in foreign currency, the bank sells the required foreign currency to its debtor. By this, the bank subscribes a foreign currency selling rate for the client.

> **Axiom 8:** There was real foreign currency purchase and sales behind the buying rate disbursal and the selling rate applied during repayment.

The foreign currency loan was an immensely popular bank product up until 2009. Its contents did not violate any sense of justice, and the transaction type widely applied by banks did not trigger the disapproval of the Hungarian Financial Supervisory Authority. The instalment rate of a CHF loan, borrowed in the summer of 2004, immediately started to decrease, and up until the autumn of 2008 it was lower than initially. In certain cases, it could have been even 20% lower. Clients could enjoy the benefits and profits derived from the beneficial shifting of the exchange rate. Consumers indebted in foreign currency still had to pay less instalments in HUF, than those who borrowed a HUF loan during the same period.

Moreover, the banks also offered a so-called exchange rate guarantee between 2006 and 2008 for certain foreign currency loans, taking the exchange rate risk. They did it to relieve their foreign currency loan clients from this risk.

Prior to the outbreak of the crisis in 2008, the banks typically procured foreign exchange resources at a low resource cost. This resource cost however tripled after the outbreak of the crisis. One of the key reasons for the increasing resource costs during this period was the growing uncertainty in connection with the forint, the Hungarian economy and the entire eurozone. This uncertainty – through the increasing resource costs of banks – also appeared in the interest rate to be paid by the client (debtor). The increase of resource costs and interest rates therefore was caused by the changing of the same exact factors, which led to the depreciation of the HUF against the CHF and EUR.

Axiom 9: The increase of resource costs and the clients' interest rates therefore was caused by the changing of the same exact factors, which resulted in the depreciation of the HUF against the CHF and EUR.

2. Foreign currency lending in Hungary

The ownership and use of acquired foreign currency was tied to strict rules for a long time in the Hungarian economy. Compared with that, the establishment of the new Foreign Currency Code Act in 1995 (Act XCV of 1995) was considered a revolutionary act. The emphasized aim of the Foreign Currency Act was to *"promote the expansion of the convertibility of HUF, the increased utilization of international commercial and economic cooperation, as well as the gradual approach towards foreign currency regulation approved by international institutions – depending on the development of economic transition."* Accordingly, the institution and system of foreign exchange control was gradually dismissed. As a first step, the Foreign Currency Act enabled free convertibility for the running payment transactions both for national and foreign citizens. In case of capital transactions, the founding of enterprises or acquisition by nationals abroad – by a registration obligation – also became possible. With other capital transactions however, the approval by the foreign currency authority still remained in effect for a temporary period, not comprehensively. Based on that, the long-term capital import by foreign citizens was not limited by the foreign currency regulation, whereas a financial type of capital export and the short-term capital import was generally only possible with a permit issued by the foreign currency authority.

Natural persons who were abroad were also able to freely purchase convertible foreign exchange and foreign currency for their personal needs qualifying as current and ongoing operations. All expenditures related to tourism and other running items could be settled without limitation domestically. They could retain the foreign exchange that they possessed, and were able to keep them on a foreign exchange account, or at home without any limitation concerning the amount as they saw fit. Taking a loan however was only possible in a very tight scope and with the disbursal of forints.

In 2001, the Government found the domestic and international economic environment appropriate to eliminate the remaining obstacles for full convertibility. The Magyar Nemzeti Bank (MNB, the Hungarian Central Bank) decided on the expansion of the HUF exchange rate range with the agreement of the Government on 3 May 2001. This step made the acceleration of the elimination of foreign currency limitations necessary. The Government decided on the complete elimination of foreign currency limitations at its session dated 5 June 2001, as well as the establishment of full convertibility of the forint. This impacted domestic and foreign economic stakeholders, organisations and natural persons. By comprehensive liberalization – among other things – the permit or the reporting obligation by the foreign exchange authority and the foreign exchange import/export obligation was terminated, and holding a foreign exchange or HUF account became free, the same as the export of foreign or domestic currency.

Government Decree 88/ 2001. (15. VI.)(5) (followed by the reinforcing Act XCIII of 2001) enabled free loan borrowing without foreign exchange limitations for national residents.

Due to the interest rate subsidy by the Government, housing loans denominated in HUF were launched from 2001 [Government Decree 12/2001. (31. I.)]. With the termination of the housing support program by the Government however (state interest rate subsidy was no longer sustainable due to the increasing retail lending in 2003), and with the substantial aggravation of the interest rate subsidizing conditions, subsidized HUF loans were replaced by foreign currency loans from 2004. From 2004 to 2005, not long after housing loans denominated in foreign currency, foreign exchange-based mortgage loans also appeared.

The foreign currency loan volume was mostly extended between 2006 and 2008, which might have been influenced by sales via agents (credit intermediaries) becoming significant from 2007 at a system level. This enabled the previous bank capacity limits to soften, and clients with lower credit rating could also access loans via intermediaries – primarily due to improper information provided to the clients.

In the specialised literature – but mostly in the political public sphere – a vivid dispute regarding the termination of retail credit lending limitation has been ongoing ever since. *György Surányi,* in his article on the traps of foreign currency lending[3] considers the legal enabling of the retail foreign currency lending opportunity as primordial sin. However, he also admits, and in his high standard study *András Hudecz* also provides detailed analysis,[4] that despite the obvious signs there was no substantive regulation of foreign currency loans until the outbreak of the crisis in 2008 – beyond the weak verbal interventions –, neither on the supply, nor on the demand side.

This study does not undertake to provide a detailed presentation of economic-legal risks which appeared before the great crisis (in the words of *Surányi*: "Great Recession"), and for the parrying of which there was at least a faint opportunity. It however can be laid down with great certainty that, *"During one or the other period of the story of foreign currency lending in Hungary almost all conditions were met, which based specialised literature contributes to the penetration of foreign currency lending",*[5] also the resulting regulating opportunities for substantively moderating the risks were omitted.

The application of the mandatory risk exposure declaration introduced from 01 January 2005 can be considered the first substantive regulation. The justification by the minister of the amendment of Act CLXII of 1996 on credit institutions and financial enterprises (hereinafter referred to as: Credit Act) stipulated: *"In case of contracts signed with retail clients, which aim at providing foreign currency loans, … the financial institution shall expose the risk for clients in the contractual transaction, the acknowledgement of which shall be certified by the client's signature. The risk exposure declaration shall contain information about the exchange rate risk in case of a contract or providing a foreign currency loan, as well as its impact on the instalment rate."* According to the justification: *"The purpose of the amendment of consumer protection regulations is to provide better and more thorough information for the clients. Thanks to the lower interest rate, the volume of foreign currency loans compared to HUF loans dynamically extended from the beginning of 2004. At the same time, the foreign currency loan also has considerable risk in case of the exchange rate fluctuation, as the instalment rates might increase, which the clients should be made aware of in a separate risk exposure declaration."*

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3 György SURÁNYI: *The traps of foreign currency lending.* Portfolio 12 May 2017 https://www.portfolio.hu/gazdasag/suranyi-gyorgy-a-devizahitelezes-csapdai.248905.html

4 András HUDECZ: *Parallel stories - The establishment and management of retail foreign currency lending in Poland, Romania and Hungary.* Hitelintézeti szemle, 4/2012, 349-411.

5 HUDECZ: i.m. 386.

The regulation – with its own possible and limited tools – tried to supplement the sometimes startling insufficiencies of the consumers' financial culture with the obligation to provide information to financial institutions. It is clear however, that the detailed and careful information was not able to make consumers aware of the fundamental financial knowledge and correlations (the teaching of which would have been a governmental task).

3.The aspirations of banks to mitigate risks before the Great Recession

3. 1. The creation of the positive list debtor record

In the regulation of loan and loan-type financial services, the central registration of credit and personal information that can be used to assess the credit application has substantial importance. The aim of the credit assessment is to enable the lending institutions to understand the solvency and liquidity of their future debtors as much as possible, and to procure the data reflecting them (extent and structure of debt) from a reliable source, possibly independent from the credit applicant. One of its most important tools is the central credit information system (hereinafter referred to as: CCS).

In accordance with the regulation that was in effect before 2011, the comprehensive registry regarding the credit history of debtors was only realized for companies. Concerning retail credit information, the amendment of the Credit Act in 1998 created the opportunity to have a so-called negative list central data registry. Retail credit and personal information could enter the central credit information system (CCS) in case of severe contract violating behaviour, also stipulated in law. These data can be freely used for credit assessment in the framework of a precise procedure reinforced by warranty items.

The necessity to create a comprehensive registry of natural persons, i.e. a comprehensive retail loan registry (hereinafter referred to as: CCR) was primarily justified by the interest related to a grounded credit assessment. The public interest grounding the governmental intervention was the increasing indebtedness of the population: the number of credit borrowing substantially increased already in the early 2000s, in which cases the credit borrower tried to satisfy their daily needs by committing to impractical credit conditions. It also happened that the debtor entering the debt spiral tried to fulfil his obligation derived from a previous credit agreement by creating a new one.

MNB raised awareness to this dangerous tendency in its 2008 Stability Report: *"In 2007, the indebtedness of households kept growing, partly due to the catch-up process and partly to consumption levelling. The debt service-to-income ratio debt service grew further, especially in the poorest households far below the average level of indebtedness. The risks hidden in the previous processes are elevated by the fact that retail credit borrowing is not shaped according to the economic processes, but it is fuelled by strong supply and the risk-based competition of financial institutions with more risks than before."* [6]

The forecasts regarding the acceleration of ungrounded retail indebtedness however were ignored.

[6] See: MNB report on financial stability April 2008. Available on the Internet: https://www.mnb.hu/letoltes/stab-jel-20080415-hu.pdf

The domestic banking system initiated the establishment of Comprehensive Retail Loan Registry in time. The positive list debtor registration proposal by the Hungarian Banking Association prepared in 2002 to 2003 fell through, because according to the Commissioner for Citizens' Rights it would have violated the right of citizens for informational autonomy guaranteed in the Constitution. According to his view, *"the limitation of the fundamental right is only constitutional, if it is due to an imperious reason, and the importance of the achievable target is aligned with the weight of fundamental right violation caused due to this"*.

The Banking Association has been taking continuous steps since 2003 to create such a registry. In collaboration with banking experts, a previously drafted solution would have made it compulsory for all debtor contracts to be recorded. This would have facilitated more reliable credit assessment, differentially lower instalments for debtors paying in a reliable and contractual manner, and on the other hand the prevention of the over-engagement of future debtors. Based on the comprehensive positive debtors' list, the credit institutions would have received more precise and more reliable information about their future debtors, who therefore would have been relieved from the procurement and attachment of countless other documentation (e.g. confirmation of outstanding debt without lenders). This procedure could also have significantly accelerated administration. The more precise risk assessment enables the differentiated application of the debtor risk surcharge, and the reduction of burdens for reliable, good debtors. You can see that the positive list debtors' registry creates a classic win-win situation: it is certainly good for the banks, and good for the reliable, good debtors, and it might also provide protection against excessive indebtedness. The above-mentioned benefits can be ensured by a comprehensive information system.[7]

In 2006, first the Commissioner for Citizens' Rights, then the Hungarian Financial Supervisory Authority also categorically upheld the necessity of the positive list debtors' registry, elaborating in detail on its advantages for both clients and credit institutions. In practice, the report of the so-called Várhegyi Committee[8] also confirmed the same. The preparatory working material prepared at the Ministry of Justice of the time (called the Ministry of Justice and Law Enforcement)[9] stipulated: *"In order to reach the regulatory target such legal solution should be created, which on one hand ensures the fullest possible decision-making freedom for the client, and on the other hand enables the creation of an infrastructure, which is able to reduce the (different kind, but equally existing) risk of lending, consequently the risk of the client, the bank, the depositors and ultimately the government and the tax payers. The law satisfies its constitutional requirement regarding proportionality, if the informational autonomy right of the client-debtor is only limited up to the level, which is required for the reliable operation of the "system". So if we accept the justification and constitutionality of*

7 Regarding the standpoint of the Hungarian Banking Association prepared by banking experts, see the presentation of Dr. Katalin Auer on certain questions of the Retail financial services held at the conference of 22-23 May 2007, under the title *"The role of the full list credit information system in credit assessment, and its connection to the central credit information system"*. Available on the Internet: https://www.mnb.hu/letoltes/20070522-23-auer-katalin-1.pdf

8 Governmental decree 1097/2006 (5. X.) set up the Expert Committee on Retail Financial Services. The president was Dr. Éva Várhegyi. The Committee prepared and publicized its proposals in December 2006 regarding the management of retail banking service-related problems.

9 Work material on certain questions related to retail financial services, July 2008

the regulatory target, i.e. that the informational autonomy right can be limited with such reason as a fundamental constitutional right, we must find the tool, by which the fundamental constitutional right can be limited in an absolutely necessary degree to reach the target."

On 13 October 2008, the Ministry made an unexpected proposal to the Secretary of State, drafted and amended by the MJL. The key features of the proposal were the following:

- the consent of the client is required both for the registration and for the disclosure of data in the registry,
- the financial enterprise managing the CCS shall manage the data for 5 years following the termination of the contractual relationship,
- the client may consent to the submission of data to the CCS subsequently as well, or at any time may also revoke consent,
- within 45 days of the law coming into effect, the bank shall inform the clients in writing about the content of contracts managed by it, the data transfer obligation, the rules regarding CCS, the purpose of the registry, and also rights of the clients. The client has another 45 days to prohibit data transfer (initial upload),
- there are complicated and strict client information rules and administrative obligations related to the management of the entire system.

The draft would basically have created a client consent-based and continuously fluctuating voluntary registry, which would have questioned the scope, comprehensive nature and reliability of the available information. At the same time, the responsibility and cost of the construction of the system as well as supplying it with data would have been borne by the banks.

The draft, in this form, however would not have been able to efficiently fulfil its original purpose of simplifying and accelerating customer service by reducing the risk of lending. Moreover, based on the completed modelling it would have had an exactly opposite effect to these targets, with a much higher cost than both during the initial upload (uploading the database with older data, e.g. from archive databases) and the daily operations. Considering all the above, the Banking Association reported, after submission, that it does not agree with the draft and therefore asked for its revocation by the Government.

The Commissioner on Data Security also expressed his concerns regarding the Government draft in the autumn of 2008. He declared: "*if necessary, I will turn to the Constitutional Court. According to the Ombudsman the Government wishes to implement the provision without a constitutional purpose, allowing for business interests. The law would provide an almost unlimited opportunity for the credit institutions to learn about the financial situation of citizens. The data security ombudsman recalled: since 1998, credit institutions have been trying to have a report prepared on people who punctually pay their debts. He believes: officials from the Ministry of Justice and Law Enforcement had a chance to learn about the dismissive view of the commissioner on Data Security at a personal consultation last week, since the strategical department leader of the Ombudsman's office stated that the legal provision drafted by the Government is unacceptable. He added: the codifiers are using the financial crisis as a pretence to limit the rights of citizens, including good debtors, contained in the basic law without a constitutional purpose, from a business interest, unnecessarily and disproportionately. The commissioner on Data Security added: with careful and responsible work in* *daily practice the banks can always clarify whether the person who contacts them for credit has proper collateral, or not. Therefore, the central database on good debtors is unnecessary.*[10]

Even at the first signs of the crisis, the Commissioner on Data Security and his office apparently did not assess the importance of creating a positive list debtors' registry as early as possible. I am convinced that quite a few debtors could have been saved from excessive indebtedness, as they were likely the first victims of the Great Recession.

In its letter dated May 2010 by the Banking Association, as a reply to the Parliamentary Commissioner on Citizen's Rights clearly elaborated, that the single and obvious objective of the positive list debtors' registry is to protect clients and to prevent their excessive indebtedness: *'We must declare, that the national legal system – considering personal rights and the priority of data security – does not substantively limit the unlimited indebtedness of private persons. As long as a comprehensive credit registration system does not exist, it cannot be prevented by a well-intentioned regulation, similar to the above. As long as the client is not listed in the currently operating CCS due to non-payment, the registry on default debtors, he is able to borrow unsecured credits with all banks and cooperative banks, as only the client's declaration is available stating that he has no debt elsewhere. The fact that it is living practice is justified by the fact, that the highest amount of live debt a client currently has in the CCS is 18, and the average number of loans per client is over1.5. We certainly do not state that all clients, or even the majority of clients get credit by misleading the bank, but we do state, that the clients are tending to overestimate their own performance. If there was a full-list credit registration system, which shows the debt burden of clients, it would be possible to set the affordable credit amount more precisely during credit assessment, or even reject the obviously not feasible applications. No such opportunity exists today, unless the lender employs visionaries. "*[11]

3. 2. Self-regulation for the simplification of credit replacement and for the fair practice of unilateral contract amendment

The Expert Committee on Retail Financial Services (so-called Várhegyi Committee) published its report in December 2006 under the title *Proposals for the management of retail banking service-related problems*. The Várhegyi Committee saw the resolution for the problems exposed in their report primarily to be the self-regulation of the banking community, and in case of failure to do so, in legislation. The Banking Association therefore founded eight working groups for creating self-regulation frameworks in the following topics:

- Working group on account channelling and collection;
- Working group on credit replacement and unilateral contract amendment;
- Customer relations;
- Basic account;
- E-contract, E-account, E-account balance;
- Financial culture and knowledge transfer;
- Inter-bank Code of Conduct;

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[10] Magyar Nemzet, Thursday, 30 October 2008, page 4.

[11] The letter of the Hungarian Banking Association to the Parliamentary Commissioner on Citizens Rights, 27 May 2010.

- Positive debtor list (work has been ongoing in this area for a long time under the coordination of the Ministry of Justice and Law Enforcement).

The working groups aimed at preparing proposals for the recommendations of the Várhegyi report in the widest possible scope. Wherever it was not sufficient, they made proposals for legislative amendment. The Board of the Hungarian Banking Association negotiated the summary proposals prepared by the working groups in the summer of 2007. The participants judged the summary to be a forward-looking and an appropriate mix of initiatives regarding self-regulation and legislation.

The competent Prime Ministerial Commissioner submitted his draft to the Government including the recommendations of the Banking Association in the middle of July 2007. In this, he made a proposal for solving the problems belonging to the scope of self-regulation and legislation. The draft stated:

> *"During the work there was always unison regarding the necessary norm changes that should possibly be executed through the self-regulation of the banking system, and legislation should ensure this supplementary, supportive framework and background. For this, the active collaboration of the banks (the Banking Association) was necessary, which it fully provided up until the current state of work: No such legislative pressure exists today that would have to be realized by governmental power despite the banks. Further, there was also unison – and this is a grandiose virtue of the initiative –, that the completed work and the formulated proposals were rated by all concerned organisations – although not of the same immediate and short-term interest – as important and significant. (e.g.: "The Office of Economic Competition welcomes proposals regarding the improvement of retail banking services, which clearly serve the reinforcement of the banking market competition.", or the opinion of IRM, according to which the summary of the Banking Association "is an extremely meaningful and high quality piece of work, …, many elements of which have such importance that might provide a strong impetus for retail banking market development".)"* [12]

Majority of the initiatives regarding legislation were not realized, or only by considerable delay and with substantially modified content. At the same time, the Banking Association working groups continued their activity and in the first half of 2008 the President of the Banking Association approved and announced on his website:

- his proposal 1/2008 for the standard management and interpretation of §.8 section (4) of the THM decree.
- his proposal 2/2008 on the Credit Replacement Code,
- his proposal 3/2008 on the Bank Changing Guide.

Under my direction, the working group engaged in the simplification of credit replacement and the establishment of the fair framework of unilateral contract amendment for consumers prepared

[12] Gyula Gaál, Prime Ministerial Commissioner: *Summary and proposal for the Government on measures to be taken in order to increase the standard of retail financial services* - Budapest, 16 July 2007.

with the Credit Replacement Code by the end of 2007. It intended to shorten the time required for a possible bank change and simplify its administration by introducing a form with unified content, as well as its standard inter-bank management. Based on widespread professional negotiations, by the end of 2008 the working group also prepared the draft of a Code on the fair practice of the unilateral amendment right regarding retail loan contracts. The consumer protection organisations (National Consumer Protection Union, and the Union of Bank Loan Victims) also collaborated on the wording, however, the Office of Economic Competition did not respond to our multiple requests. Considering the developments of the financial crisis, the Board of the Banking Association considered it necessary to supplement the text of the Code with beneficiary conditions for the consumers.

From the very beginning, the Office of Economic Competition has sought for regulation on the legislative level. During 2008, they presented their proposal regarding the amendment of the Credit Act three times (in March, August and December) on different forums, practically with the same content. However, the proposals of the Office of Economic Competition were steadily and resolutely rejected each time by the experts present (IRM, Ministry of Finance PM, Hungarian Financial Supervisory Authority, consumer protection organisations and the Banking Association), by pointing out its professional insufficiencies in detail and also its expected, quite unfavourable impacts on the Hungarian economy. The view of the Office of Economic Competition in contrast to the professional arguments was fairly simple: the office of competition did not believe in the efficiency of the banks' self-regulation. Their standpoint was surprising also because despite several invitations they did not participate in the meetings of the Banking Association working group, hence they did not have the opportunity to contradict the professional work either.

Following such antecedents and one week after the professional dispute in December 2008, on 23 December 2008 the Government (without the mandatory professional reconciliation specified by the law on legislation) submitted Bill T/8183 to the Parliament on the amendment of certain acts concerning the supervision of the financial intermediary system. The submitted government bill contains the proposal from the Office of Economic Competition almost verbatim, which has been rejected several times professionally. On 9 February 2009, the Office of Economic Competition publicised (according to my view illegally, by violating the procedural rules of the Competition Act)[13] its sectoral investigation report, which also included a professionally quite disputable amendment proposal.[14] Afterwards, the President of

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13 According to Act LVII Section 43/E § (2) of 1996 on the prohibition of unfair market behaviour and the limitation of competition: *"Before the report is adopted, the undertakings operating in the sector shall be given an opportunity to submit comments about the contents of the report in writing. To facilitate this process, a draft version of the report with restricted access data removed shall be sent to the undertakings operating in the sector for comments in due time to allow at least thirty days for the submission of their comments. The Hungarian Competition Authority shall publish on its website the report on the findings of the sectoral inquiry, the summary or minutes of the written comments or of the hearing, and – if requested – the documents containing the substantive comments made by the undertakings operating in the sector regarding the contents of the report, with restricted access data removed."*

14 http://www.gvh.hu//data/cms998828/banki_ágazati_vizgy_2009_02_09_pdf.pdf
The written observations prepared by the members of the Banking Association regarding the Sectoral report were subsequently published upon the explicit request of the Banking Association: http://www.gvh.hu//data/cms998829/banki_ágazati_vizgy_észrevétel_Bankszövetség_2009_06_16.pdf

the Office of Economic Competition in his letter to the Prime Minister dated 6 February 2009, proposed a broader and more practically retroactive extension than the planned regulation.

Once they were made aware of the submission of the government bill, the Banking Association working group made a proposal for the Banking Association Board for the rapid approval of the substantially completed *Code on Unilateral Contract Amendment* and to make it public in the widest possible scope. This would have created an opportunity for the presentation of self-regulation based on intense and wide-scope professional consensus and the related banking opinions. The Board however did not approve the proposal, instead, at the session of 2 February 2009 they decided to write a letter to the Prime Minister. This way the self-regulation of the banking community did not appear at all.

From the very beginning, the working group had the prevailing approach that the most efficient tool for protection against unjustified unilateral contract amendment is to establish the opportunity for quick and cheap credit replacement. If the debtors have such a tool available, in case of a disadvantageous amendment for the debtor, they can be relieved from the impact of disadvantageous changes by replacing the lending bank, and the financial institution carrying out the unjustified amendment loses its client, and therefore the market. Based on the proposal by the working group, the protective tool against unfair unilateral contract amendment would not have been the strict, detailed regulation of the unilateral amendment or the prohibition of modification. Namely, the regulation considering all future events is on one hand impossible, on the other hand such a regulation would make the system unnecessarily rigid and expensive, the unfavourable effects of which would encumber the consumer. If, however we enabled the reduction of the consumer's defencelessness by simplifying, accelerating and decreasing the administration and costs of the credit replacement, the same consumer protection goal could be achieved by a market-conformity solution.

The realization of this goal however cannot be carried out by mere self-regulation, since it does not impact the activity of market stakeholders outside the banking system. Consequently, legislation supporting the objective has become necessary in the following areas:

- introduction of a contract template for notarial documents on the financial services market,
- supplementation of rules regarding the preliminary notification of clients,
- review of rules concerning the disadvantageous amendment of contractual conditions for the client,
- responsible lending and publicity,
- problems of financial product mediation, in this context a required amendment of the competence of the Hungarian Financial Supervisory Authority,
- preparation of a comprehensive regulation regarding retail credit registration,
- bankruptcy procedure to settle the debt of natural persons,
- completion of the consumer's obligations based on the credit agreement before the deadline,
- foundation of a consultation council on financial services,
- the client's right to terminate the contract,
- efficient settlement of legal disputes in the field of retail financial services,
- review and modify the competence of the Hungarian Financial Supervisory Authority as necessary,
- regulation of switching bank accounts,

- inspection of the introduction of a so-called social account,
- financial culture in public education.

You can see that a consumer protection objective can be efficiently realized with the aligned and diverse cooperation of legislation and self-regulation. However, the high standard professional working material prepared in the Ministry of Justice and law Enforcement in July 2008 was not discussed. Instead, the standpoint of the Office of Economic Competition was approved, which was professionally criticised multiple times.

The importance of unilateral contract amendment in a banking approach

The fundamental function of a bank is to provide loans from the deposits placed with them. The bank does not provide the loan from its own money, but from those of the depositors: as a financial mediator it lends the temporarily surplus money of depositors to the credit borrowers, who apply for it. In Hungary, only the banks are eligible to collect depositors, and they should be able to repay the deposits to a full extent.

However, one must also consider that the loan agreements mean long-term – often 20 to 30-year – commitment, which should be financed by the banks typically from short-term deposits. Such long-term resources cannot be found on the monetary and capital markets, which the credit applicants would need. Therefore, the banks must create a balance of the maturity of assets and resources in a way that the coverage for the repayment of maturing deposits is available from continuously incoming redemptions and newly borrowed resources. To renew resources and to outsource new loans new sources are required, the procurement of which is influenced by varying monetary and capital market circumstances: the quantity of available resources, and the willingness of the financing parties to take risks. The asset-resource management of banks was previously supervised by the Hungarian Financial Supervisory Authority, and currently by the MNB according to strict legal provisions.

The outsourcing of banks should adapt to the needs of the borrowers by also taking the consequences of the market competition into account. This adaptation should be met in the currency, maturity and the amount as well. The banks are able to fulfil these requirements by transforming the resources collected from depositors during the outsourcing of loans in maturity, amount and risks. The risks of banks can be partially derived from the above-mentioned transformations. Maturity transformation is one of the key features of banking. The investors are normally able/willing to give up their savings for a shorter period, while the credit borrowers generally need liquid resources, which are available for longer. During the maturity, the banks transform the short-term savings into long-term loans, while they perform a so-called positive transformation.

The sustainment of the depositors' trust at any cost is the pre-condition for enabling the applicants in the economy – private persons and business organisations – to actually obtain credit.

Both the size of the deposit and loan interest rate are defined by the monetary market situation, and ultimately the circumstance of the real sphere at one given time. The monetary market situation and the influencing real market circumstances can change from time-to-time, which changes might have an impact on the counter value (interest rates) of money usage through complex transposals. It is a realistic expectation, that the parties adjust the level of interest rate to be paid during financial services to the financial market situation at times. The unilateral amendment of the interest rate is one of the tools of managing the risk that arises in the unforeseeable monetary market fluctuations. And, it can be easily understood that it is a fundamental interest of the banks to provide the resource with the most beneficial condition available on the market (cheapest and with the longest duration) behind their loans.

The fluctuations of the monetary market are not foreseeable either by the bank, or by its client, and both parties are impacted either beneficially or unfavourably. Therefore, it is the primary interest of both parties to continuously adjust the level of interest rate to the prevailing monetary market situation. The unilateral contract amendment is a legal option to maintain the pricing of long-term services in an economically justified way.

In the case of all long-term contracts, the option for contract amendment is available due to changing conditions, considering the rule of *clausula rebus sic stantibus.* The changing conditions might directly impact the risk-taking of clients compared to the situation of the time of contract signing in case of an insurance, rental, or even a public utility contract. Their limitation would mean in practice, that the changed market risk cannot be exercised in the contractual relationship of the parties. Consequently, one party would have to necessarily perform contractual obligations at higher risk, being isolated from the value conditions of the market, while the other party would get richer in an unauthorized way (we would like to emphasize, that the market conditions might change to the advantage/disadvantage of any contracting party, hence the exclusion of the right for unilateral contract amendment might be unfavourable for any party).

The right of unilateral contract amendment in a legal approach

A legally signed contract according to the traditional principles of civil law is binding for both contracting parties, the parties shall only deviate from its rules by common will, and shall only modify it by mutual agreement (*pacta sunt servanda*). The entitlement of any party to carry out unilateral amendment in the contract mutually established by the parties without the explicit declaration of the other party is quite an exceptional case, and the legal regulation allows for such in only very justified cases. The constitutional reason for the "exceptionality" of the limitation is the *clausula rebus sic stantibus*, i.e. such substantial alteration of the circumstances in the background legal relationship of credit contracts that due to it the ratio of rights and obligations constituting the content of the legal relationship fundamentally change, and the sustainment of the contract with unchanged content would violate the rightful interest of one of the contracting parties. The substantial economic – possibly political –, financial and other social changes clearly impact especially the long-term contractual relationships (war, crisis, inflation, political risks, economic nullification, etc.). The unforeseen circumstances during the signing of the contract can considerably alter the situation of the contracting parties, the ratio of rights and obligations, as well as making the completion of the contract for one of the parties extremely cumbersome or even impossible with unchanged content and the completion of the contract [Decision AB 32/1991. (6.VI)].

According to the above, the right of unilateral contract amendment is a constitutional right based on free market competition and contractual freedom.[15] The recognition in a legal provision that in long-term legal relationships a mechanism is needed, which ensures that the service and counter service are equivalent. It is especially justified in case of such contracts, in which the services are completed asymmetrically in time, i.e. the time of performance by the parties is different. In case of financial services, a unilateral contract amendment might be justified by the alteration of the legal, regulatory environment or the monetary market conditions, the modification of the macroeconomic environment and the operational conditions of the bank.

The law considers the option of unilateral contract amendment as an exceptional tool, and only allows for the amendment of the contract's pre-defined conditions by fixed and strict formalities, i.e. applies it as a risk management tool. This exceptional opportunity is provided by law in consideration of the unique nature of financial legal relationships. The loan contract is an asymmetric legal relationship regarding time: the lending party basically completes its main service at the very start of the legal relationship, whereas the debtor does so continuously during the legal relationship, even up to several decades, depending on the duration of the loan.

On 12 February 2009, at the State Budget Committee's debate session on the Government Bill submitted without preliminary negotiation as stipulated by legislation, both the method of submission and the content of the bill were almost unilaterally objected to, regardless of political party. They would have considered the execution of a professional debate useful, at the same time the committee found the proposal suitable for general debate. The Parliament passed the proposal on 23 March 2009, which was adopted as Act XIII of 2009.

The text of the law brought up numerous theoretical and practical feasibility issues. These were reported by the banks and the Banking Association already prior to passing the law, but especially afterwards, both to the legislators, supervisory bodies and the President of the Republic, however to no avail.

Following the pronouncement of the Act, the financial institutions – in consideration of the necessary contract amendment, IT, educational and internal regulatory activities in an extraordinarily short time – tried to satisfy the provisions of the Act based on their best abilities. Their endeavour however was unsuccessful due to the inner contradictions of the legal provision.

15 See AB Decision 32/1991. (6.VI.) point III/4.

The unenforceability of the regulation became obvious when, according to the legal provision, the banks published the amendment of their general contractual conditions on 15 July 2009. This already incorporated the list of reasons enabling the unilateral contract amendment by the banks.

Once the legislator understood that the legal regulation required modification, a decision was made on 14 July 2009 on the preparation of a code of conduct. This – among others – included those circumstances, referring to which the banks could unilaterally modify the previously signed contracts. Simultaneously, with the preparation of the code the Government committed to prepare the necessary amendment of law. The banks committed to only exercising the unilateral contract amendment unfavourably impacting the consumer following consultation with the Hungarian Financial Supervisory Authority.

The Hungarian Financial Supervisory Authority, in reconciliation with the ministries and the Office of Economic Competition, prepared a draft which was supplemented and refined by the banks based on professional criteria. The law amendment was passed by Parliament on 14 December 2009 and came into effect on 1 January 2010.[16] The key provisions of the amendment were the following:

1. The other contractual condition of a loan or financial lease contract signed with a micro-enterprise – unlike the previous regulation – was possible to amend unilaterally, unfavourably for the client from 1 January 2010. In case of the same contracts, the contractual conditions regarding the interest rate and fee could be amended unilaterally, unfavourably for the client by public notification 15 days in advance. (In case the relevant contracts included the previous stricter regulations, the bank still had to proceed according to the contracts until the relevant sections were amended.)
2. The bank – should it wish to exercise its unilateral contract amendment right – primarily has to meet two conditions: (1) the contract shall include the itemised description of objective circumstances justifying the amendment, and (2) the bank has to create written "pricing principles". The law specifies the mandatory minimum content of pricing principles
3. In order to make the amendment understandable for the client, the financial institution shall send notification about the amendment via postal letter or other "permanent data carrier".
4. In case the interest rate changes due to the amendment of the reference interest rate, the provisions regarding the notification and free cancellation do not need to be applied. If the interest rate is indexed to the reference interest rate, the rules of notification are specified by the Act on Consumer Loans (Act 2009 of CLXII).
5. The legal compliance and application practice of pricing principles – including compliance with the contents of the Code – is controlled by the Hungarian Financial Supervisory Authority. The intention of the legislator based on the text and justification of the Act was most likely a subsequent norm control. During the inspection, the Authority considers the provisions of the code of conduct approved by the Authority and belonging to the scope of Act XLVII of 2008 on unfair commercial practice against consumers.

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16 Act CL of 2009 on the amendment of certain acts related to financial topics

6. In case of a state subsidized housing loan, unlike the general (60-day) rule, it is sufficient to announce the unfavourable, unilateral amendment to the client 15 days prior, and it is not mandatory to notify the concerned clients via direct post or other means. [The justification of the Act includes the following: *"Different rules apply to housing loans with state interest rate subsidy. Namely, with these loans the limit concerning the upper threshold of the credit fee is published on a monthly basis by the National Debt Office and it shall be applied from the following month on, therefore the financial institution is not able to provide information 60 days prior to the date of effectiveness of the amendment."]*
7. The loan agreements signed after 1 January 2010, and financed by a mortgage debenture shall explicitly include that, *"the loan is financed by a mortgage debenture or the client wishes to have it financed by a mortgage debenture, as well as its legal consequences. In case of refinanced loan agreements by a mortgage credit institution, the client shall be informed latest within 30 days from refinancing by a posted notice about the execution of refinancing".*
8. From 1 January 2010 on, the announcement on interest rate, fee or cost item amendment shall unambiguously indicate (1) which interest rate, fee or cost item, (2) to what extent and (3) reason for increase.
9. The Credit Act specifically contained that the bank (according to the intention of the legislator presumably without the obligation of pre-notification) may amend the contract unilaterally, not unfavourably, for the client. This provision had to be applied to contracts signed before the date of effectiveness.

4. Debtor protection programs of banks

As a consequence of the normal operations of the banking system, it is the fundamental interest of the bank to promote the complete repayment of loans, by even providing discounts to their debtors. The intention of the bank is aimed at having the liabilities enforced by legal means and auctioning off the real estate collateral in the case of as few loans as possible. The bank is a financial mediator, and the liquidation of collateral objects or assets is a time-consuming and costly process. Therefore, the bank strives to support its debtors in reinstating normal redemption order.

For the efficient solution of redemption problems emerging due to the world economic crisis, the banks provided substantial redemption discounts to their debtors under the available boundaries. The banks generally tried to provide flexible solutions most suitable for the individual lifestyle. They aimed at helping those clients, who previously paid their loans denominated in foreign currency or forints, however, due to loss of job, the reduction of the overall family income, or the considerable growth of the foreign currency exchange rates the further redemption of their loan experienced a problem.

The following measures were taken in the framework of debtor protection programs of banks, which were prepared before the state measures and carried out in practice:

a) In November 2008, the banks signed agreements with the Ministry of Finance, according to which in case of clients with loans registered in foreign currency, they introduced measures to moderate the burdens due to the increasing instalment amounts. In the framework of the measures, the banks committed to provide free opportunity based on the debtor's request for prolongation, and in case of converting foreign currency loans to forints, they do not charge any banking fees arising upon conversion until 31 December 2008, and shall handle the early repayments until 31 December 2008 flexibly. With this, the banks temporarily waived the payment of several fees, or took them over from the clients. Normally the banks provided a lot more concessions to clients, than what they committed to in their agreement with the Ministry of Finance. The original deadline of 31 December 2008, stipulated in the agreement, was prolonged, and they made allowances in many other areas for clients (making pre- or early repayment of outstanding debts free and extending it for housing loans in HUF).

b) Beyond the agreement with the Ministry of Finance the banks – in many cases even before the date of effectiveness of Act IV of 2009 on Government Guarantees for Housing Loans – prepared their own debtor protection programs. In many cases, they provided an opportunity for debtors to apply for the temporary reduction of the paid instalment rates and/or prolongation.

Therefore the banks generally ensured, even before the governmental measures, that proper tools were available for clients having payment difficulties to bridge their redemption problems. The banking measures impacted a wider scope of people than the credit protection program planned by the Government, which exclusively targeted clients with foreign currency loans, who became unemployed during the crisis, as well as those who suggested that the payment of the foreign currency loan caused great hardship for them, but were not in default yet.

Besides the direct benefits, we should not ignore the fact that due to the contradicting processes in real estate lending appearing as the sign of crisis (due to the exchange rate fluctuation there was a real estate collateral, which value dropped down to its fraction against the boomed credit debt), exposure to the prudential risk of the equity gap was borne by the banks, without asking for the usual collateral supplementation, which would have been justified at this time.

5. Debt relief legislation

5. 1. Bridging loan (Act IV of 2009 on Government Guarantees for Home Loans)

The aim of the Act was to support debtors in need by providing temporary help from the Government in the form of government guarantee to those natural persons, who met the stipulations of the Act. The natural person, as a debtor, could initiate the signing of a bridging loan with the financial institution that provided the housing loan in case an employment relationship was terminated.

The financial institution disbursed the bridging loan by the last day of the 24th month following the signing of the loan agreement in an equal amount of the sum of the due instalments of the housing loan and the instalment rate committed to by the debtor, also equalling the previously due but not yet paid instalment. The bridging loan could only be used for payment of the housing loan. The housing loan was redeemed from the amount paid by the debtor and the bridging loan. Until the last day of the 24th month following the signing of the loan agreement, the debtor was not bound by a payment obligation, and afterwards he only had an obligation to pay the interest rate on the capital debt. The bridging loan had to be repaid in maximum 10 years, provided that its maturity date did not exceed the maturity date of the housing loan.

If the debtor breached the credit agreement, the government guarantee applied to the amount disbursed until the date of contract breeching. If the financial institution cancelled the housing loan, the bridging loan also had to be terminated. The financial institution could initiate the enforcement of the government guarantee by the 30th day following the date of maturity, or in case of cancellation, the termination date. If during the exercising of the government guarantee or the collection of debt, the tax authority established that the debtor or another member of the household cheated the financial institution, the natural person had to pay 150% of the paid amount upon the exercising of the government guarantee.

Upon the termination of his employment the natural person, as debtor or co-debtor, could not have an over 90-day default debt, which exceeded the amount of the lowest minimum wage or the monthly instalment rate.

The amendment of legal conditions was subsequently necessary to extend the scope of eligible persons, who could overcome their financial difficulties with state support.

The number of loan agreements did not reach 3,000 from the date of effectiveness of the Act up until October 2009, which significantly stayed below real demands. The low number of eligible people is the result of the strict conditions, which excluded part of the interested debtors from applying for the bridging loan. Despite the moderation of the rigour, the construction was still not too popular, it was only utilized by a few hundred people.

5. 2. Legal provision on prudent retail credit lending conditions and creditworthiness assessment

Government Decree 361/2009 (30. XII.) on prudent retail credit lending conditions and creditworthiness assessment came into effect on 1 March 2010. The Decree introduced a new lending-related concept: the lending limit. Based on the internal regulations of the lender, it was an amount defined in forints, reflecting the maximum monthly instalment paying ability.

According to the new regulation, the lender shall not provide a loan by only taking the real estate collateral into account, but with all credit assessment it shall inspect the creditworthiness and creditability. According to the internal regulations of the lender, this inspection should be based on the income situation of the natural person and the household, and the consequently defined lending limit. The regulation sets out detailed requirements regarding the contents of the internal regulation.

Based on the regulation, the monthly instalment rate with EUR and EUR-denominated loans must not be higher than 80% of the lending limit upon disbursal. With our foreign currency loans, the initial instalment rate should not exceed 60% of the lending limit.

The regulation specifies that during the establishment of the lending limit the lender shall consider all known debts of the client that are outstanding with the lender or other lenders. The lender is obligated to proceed with the caution expected in the scope of lending in order to explore the client's financial situation, including the inquiry of all credit information systems to which he or she is a member.

The regulation was amended by Government Decree 152/2010 (30. IV.). The amendment contains technical refinements that simplify application, but it did not solve the fundamental problem of the regulation: the regulation was late and in the absence of a full-list credit registration system, the creditworthiness check is built on non-verifiable information. The integration of the lending limit also hinders the replacement of the existing credit volume, since with the assessment of the new loan the internal regulation restrictions and the creditability limit for foreign currency loans should be taken into account. In case of loans with real estate collateral, the integration of the loan to value limit (LTV) for real estate purchase or construction substantially increased the own funds, to which the clients were not able to adapt to with the income and financial conditions of the time.[17] The late austerity measures held back the demand for loans and indirectly had a negative effect on the construction industry, thereby elevating the negative processes of the economic crisis.

Due to the crisis, the majority of banks voluntarily imposed restrictions regarding loan assessment even before the regulation came into effect, both in the field of creditworthiness and real estate collateral.

Concerning the absence of a positive list debtors' registry, we already quoted the letter sent to the Parliamentary Commissioner on Citizens Rights by the Banking Association dated May 2010.[18] In this letter, the Banking Association implied that – despite good will – the late regulation did not address the root of the problem, only its symptoms:

"If the lending and borrowing of loans was handled responsibly by the contracting parties, there would be no solution even by careful credit assessment for those cases when the client loses his job, or in case of a married couple, both parties become unemployed. We are convinced that the decisive factor from the aspect of default loans by private persons is not the increasing instalments of foreign currency loans, but the labour market situation. The amendment/tightening of execution-related rules in itself does not provide sufficient guarantee for the prevention of default loans by private persons. With cases that are already in the implementation phase, the position of the debtor and the lender are given, the same as the extent of liabilities, and it is impossible to change the value of the collateral. Re-contracting in case of cancelled loan agreements is also primarily a business interest for banks following fair market conduct due to lower collateral values as a consequence of the crisis. Unfortunately, the development of external factors (e.g. size of unemployment) is not a question of the above-mentioned regulation, if the debtor is not able to pay even the minimum amount, this tool cannot be applied."

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17 During the crisis, the value of real estate (consequently of the collateral) declined, therefore one could take a substantially lower loan by the same collateral, with a considerably higher own funds. However, under the domestic income conditions it was not always possible.

18 The letter of the Hungarian Banking Association to the Parliamentary Commissioner on Citizens Rights, 27 May 2010.

5. 3. Amendment of Act LIII of 1994 on court execution (prolongation of the eviction moratorium)

Act LIII of 1994 on court execution (hereinafter referred to as: ExAct.) has prohibited execution regarding residential properties during the winter period since 2003. Based on the legal prohibition, the executor shall postpone the eviction of residential properties from 1 December to the period following 1 March, if the obligor is a private person.

Based on the amendment of the ExAct passed in July 2010, the duration of the prohibition was extended in 2010, so the eviction of the housing unit should be postponed not only from 1 December, but already from the day following the receipt of the court decision ordering the eviction, or the request of the auction customer – earliest from the day following the effective date of the Act – to 15 April of the next year (based on the later amendment passed in March 2011, the eviction moratorium lasted until 1 July 2011).

According to the justification of the Act, the aim of the legislator was to "*provide temporary moratorium for the eviction of their flats to those debtors and obligors, who are actually threatened by eviction, who are not able to take care of their housing. The population has accumulated substantial debts in the form of loans, and due to the financial-economic crisis, their other debts have also increased. A substantial part of debtors were not able to settle their debts, due to which their properties have to be sold…. The Proposal is a temporary regulation: the aim of prolonging the eviction moratorium is a temporary intervention in the order of exercising the claims, which was made necessary by the financial-economic crisis as an extraordinary circumstance. During the moratorium therefore those debt management institutions should be created, which support debtors start a new life, and also serve the enforcement of claims in the long-run, but at the same time also the prevention of becoming homeless.*"

Following the adoption of the law, the Banking Association expressed its concerns regarding the constitutional and other legal provisions in conflict with other legislation. Based on the justification of the Act, the creators of the legal provision thought that forced eviction could only be carried out due to cancelled loan agreements, however, the eviction moratorium was established with full scope (e.g. the needs of private persons based on final judgement also fell under the scope of the amendment). As per the justification, with the moratorium they wished to help those who were not able to take care of their housing, however, by general regulation the Act also extended the moratorium to those who had other housing, or another housing opportunity. Since the ordering of court execution may only take place following the legally binding proceedings by the authorities or the court, the forced suspension of the execution procedure for nearly one year severely violated the rightful interests of parties having adverse interests in the proceedings, furthermore, the constitutional requirement of the rule of law and indirectly legal security. It might lead to legal uncertainty, if the eligible cannot access his claim even despite a legally binding court decision, and also that the reliability of the contractual security system is disrupted.

According to the Credit Act, the subject of the credit risk collateral may be liquid or 'value certain' assets. The so-called recognizable credit risk collateral may be such an asset which the lending credit institution is entitled to sell within a reasonable time in or outside court execution. Government Decree 196/2007 (30. VII.) on lending risk management and capital requirement specifies further conditions regarding the recognition of fixed assets as the credit risk collateral encumbering the property. These rules are based on the decrees of the European Union: Decree 2006/48/EC (Basel II.)[19] on commencing and continuing operation of credit institutions disposes of this.

According to the opinion of the Banking Association, the rule of law and legal certainty by the provisions of the Act contradict the requirement of constitutionality, especially the ordering of immediate entry into force upon announcement and prompt application in case of pending cases. Additionally, the organisation believes that the Act breached the constitutional principle of property rights. It also referred to the fact that the submission and approval of the government bill was not preceded by professional reconciliation.

The eviction moratorium is an extremely sensitive point of property credit lending. On one hand, based on legal provisions and banking considerations, the selling of collateral might be necessary for the sake of the money outsourced as credit by the depositors On the other hand, however, it should be appreciated – especially in an emergency situation –, that families are not to be evicted on the streets during winter. This sensitive, balanced situation was thrown off by the legislator with the prolongation of the eviction moratorium.

It would have been a considerable option – based on the practice of other countries – to place the evicted tenants in social rental flats. During the 1990s, in Hungary, however this type of housing was practically eliminated. The idea of creating the National Asset Management arose as another option. This concept was already put to the Government by the Hungarian Banking Association, but the Government did not address it for a long time. The eviction moratorium introduced, instead greatly elevated the moral risk of foreign currency lending, creating the expectation in debtors that a "caring government will anyway save them".

5. 4. Required law amendment in order to limit mortgage-ensuring foreign currency loans – Act XC of 2010

According to the justification of the law amendment: *"The aim of the amendment is to stop the penetration of foreign currency loans, prevent excessive indebtedness of clients so that the number of people in dire straits does not grow."* Due to the financial crisis, the lending of new foreign currency loans has now declined to a negligible extent, so the spectacular measure was basically banging on open doors. In addition, due to the inaccurate wording of the approved text, it could have led to the land registry offices not registering the new mortgage contracts made under the credit replacement. The text of the law incorrectly referred to this procedure as "amendment registration". In contrast, the Property Registration Act only considers changing property data, or the name, registered seat and address change of the entitled as amendment registration. If the law was not amended, there would have been a risk that the credit replacement by banks shut down, and with this the cancellation would have impacted new non-paying debtors.

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19 The regulations of Basel II. strictly define the rules of the credit institutions' prudential operations, hence the consideration of fixed assets as the credit risk collateral encumbering the property. If the real estate collateral can not be enforced according to the effective rules contained in the ExAct. upon accepting the collateral, it leads to a prudential problem (see Government decree §12. More on this topic: https://www.mnb.hu/archivum/Felugyelet/root/fooldal/bal_menu/eu/eu_felugyeletek/cebs/bazelII_modszertan/crd_jogsz

The amendment in this form was not suitable to reach the aim of the legislator, since excessive indebtedness could be triggered not only by loans in foreign currency, but also those in HUF. Moreover, the problem was not caused by the existence of credit insurance (collateral), but the exchange rate fluctuations influencing the instalment rates of foreign currency loans.

Concerning the regulation, the violation of EU law also emerged. One year earlier, the European Court (hereinafter referred to as: EUC) ruled, in an uncannily similar case to the Hungarian regulation,[20] that the indexing of mortgage registrations to the national currency breaches the principle of free capital flow, and such limitation might indirectly prevent free capital flow. According to the EUC, lending is one of the main channels of capital flow, and one of the fundamental, inseparable insurances of lending – especially in case of real estate – is mortgage. The decision, on one hand, pinned down that the exclusion of mortgage that can be registered in the currency of another member state violates free capital flow. On the other hand, the court stated that it does not recognize situations that might be considered as exceptional, which would justify the restriction.[21]

5. 5. Act XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in a difficult situation due to taking housing loans

The Credit Act amendment restricted unilateral interest rate increase in case of housing loans, and prohibited the increasing of costs and other fees. According to the provision of the Act, the financial institution may amend the housing loan or financial lease contract exclusively regarding the interest rate unfavourably for the client, if the central bank's base interest rate, the refinancing interest rates, the financial market indexes, the lender's fixed client deposits' interest rate changes, the regulatory environment, or the modification of credit risk defined in a government decree justifies it. The Act authorized the Government to establish the cases, conditions and means of unilateral interest rate amendment in a regulation.

The Hungarian Financial Supervisory Authority did not agree with the direct regulation of the Act approved based on the proposal that was submitted as a representatives' initiative. Based on the opinion of the Supervisory Authority, they should have started from the prohibition of contract amendment by indexing the credit interest rates to the reference interest rate.[22] The Act however followed a different regulating direction, based on which the conditions and means of interest rate increase could be determined in a government decree. In its opinion, reflecting on the law amendment proposal, unlike the contents of the proposal, MNB also would have considered a reference-based interest rate and a fixed surcharge as acceptable in case of all loans.

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20 Case C-222/97 (Prohibition by a Member State of registration of a mortgage in the currency of another Member State - Not permissible)

21 http://curia.europa.eu/juris/showPdf.jsf;jsessionid=9ea7d2dc30db5ffad902f1d146768c06a87e75a1e7bf.e34KaxiLc3qMb40Rch0SaxuLa3b0?text=&docid=101448&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=1103421

22 See: Észak Magyarország, Kelet Magyarország, Hajdú-Bihari Napló – 01 July 2010, pages 1- 2, Észak Magyarország, Kelet Magyarország, Hajdú-Bihari Napló - 02 July 2010, pages 2-3, 06 July 2010, m1: Híradó délben, Magyar Nemzet - 07 July 2010, pages 1 and 5, Népszabadság - 07 July 2010, pages 1 and 9

The Banking Association – apart from its concerns regarding constitutionality – pointed out that in many banks the client could pay the loans denominated in foreign currency in foreign currency as well, and in such cases the question of exchange rate loss did not directly occur. Other banks also applied their own foreign exchange buying rates for redemption as well, which was by all means lower than their own central rate, and in certain cases even than the central rate of MNB. Again, different banks introduced unilateral moderations based on their own initiative, for example applied their own or MNB's foreign exchange central rate instead of their own foreign exchange buying rate, until the HUF appreciated over a certain level relative to the CHF. There was also a bank which offset the exchange rate loss suffered by its debtor by reducing the interest rate. Finally, there was also a bank where the client could choose whether they wanted to pay in HUF or foreign exchange. It was a general feature that with the credit replacement aimed at currency swap the banks did not charge an extra fee.

Whatever was effective, a large part of banks already did. Therefore my view is that instead of legal regulation it would have been better to publish these procedures as best practice: either in a document by the Banking Association, or as a methodology guide of the Hungarian Financial Supervisory Authority.

5. 6. Eight-point proposal targeting the support for housing loan debtors

On 10 September 2010, the larger government party announced in front of the press an eight-point proposal targeting the support for housing loan debtors indebted in foreign currency. The package contained the following items:

1. Contract amendments unfavourable for clients is prohibited
2. "Voluntary" interest rate increase is prohibited
3. The application of the central exchange rate is mandatory (it is still to be decided, whether it should be a bank, or the central bank)
4. Free early repayment
5. The duration can be automatically extended by five years
6. No more than the actual market value can be claimed from the debtor (the "right to start with a clean slate")
7. In case of insolvency, no penalty interest rate, or any other extra fees can be charged
8. The measures should not cover either business investments, or second or third property lending

The Banking Association did not agree with the proposal. In addition to sounding constitutional concerns, they also objected that the program points appeared without previous professional consultation. They again advised, that

- contract amendments can only take place in order to offset the value balance caused by the exchange rate fluctuation,
- the application of the mandatory central rate might be unfavourable for the debtor in numerous cases,
- The unilateral modification of the contract duration does not solve, only postpone payment difficulties,
- The "right to start with a clean slate" severely violates the risk management rules.

The proposal of the Banking Association for solving the problem was already in front of the Cabinet and they were waiting for their feedback. The organisation had already forwarded its proposal more than a year earlier to the Government, although it was the previous Cabinet. The Association however did not get a reply from either government. The proposal of banks was basically identical with the concept of the National Asset Management. The idea of the financial institutions was that those loans which cannot be helped with banking tools (e.g. because the debtor lost his job, so he is not able to pay the lowered instalment rate either) should be assumed by a state organisation along with the concerned flat. The organisation can rent the property out as a rental flat to the previous owner, so he does not have to leave his home.

The proposals of the governmental party group of representatives was transplanted into a legal provision by the amendment of two acts: the Credit Act and Act CLXII of 2009 on consumer loans (hereinafter referred to as: Consumer Loan Act). The amendments contained all elements of the program package except for the “right to start with a clean slate”.

5. 7. About the amendment of Government Decree 361/2009 (30. XII.) on retail credit lending conditions and creditworthiness assessment

The amendment of Government Decree 361/2009 (30. XII.) on retail credit lending conditions and creditworthiness assessment took place based on the initiative of MNB. The aim of the amendment was to promote the replacement of loans and to boost competition.

According to the amendment of the Government Decree, the LTV limits regulated in the Decree does not need to be applied for the replacement of previously signed loans. There is an opportunity for this if the client converts his foreign currency loan into EUR or HUF loan, or changes the HUF for another HUF loan, and the credit debt does not increase in the meantime, not considering the exchange rate difference between the lenders.

The amendment also enabled the replacement of a foreign currency loan denominated in CHF by a CHF-denominated loan. In addition, the amendment stipulated that it does not qualify as an increase of debt if the amount of the new loan exceeds the debt with certified costs related to the borrowing of the new loan.

The amendment supplemented the scheduling and the provision regulating the amendment. Accordingly, the provisions of the regulation do not need to be applied for the modification and rescheduling of existing loans, even if the original and the new loan are CHF loans or CHF-denominated loans.

5. 8. Omnibus account loan, exchange rate cap – Act LXXV of 2011

The essence of the construction was that the debt emerging in the exchange rate range over the fixed rate was registered on a separate omnibus account loan. The financial institution ensured the HUF amount of the difference between the applied instalment rate and the fixed exchange rate along with the settlement of completion by disbursal from an omnibus account loan. The financial institution did not establish payment obligation by the credit debtor derived from the credit amount contract regarding the omnibus account up until the closing date of the application period. Afterwards, – taking the outstanding omnibus account debt as basis –the monthly instalment obligation was determined based on the rules of annuity.

The Government provided government guarantee for 100% of the debt. The pre-condition was that the lender terminated the loan agreement and the omnibus account agreement due to default by the debtor over 180 days, or enforcement proceedings against the collateral during the application period of the fixed exchange rate. The government guarantee took place if, following the application period of the fixed exchange rate, the lender terminated the loan agreement and the omnibus account agreement due to default by the debtor over 180 days, or execution proceedings against the collateral and by normal enforcement rendered the loan or a part of it irrecoverable.[23]

The Government and the Banking Association signed an agreement on 15 December 2011, based on which the law was amended in March 2012. The exchange rate cap was extended so that over the specified exchange rate the bank and the Government assumed the interest rate payment from the debtor. The payment of the capital over the specified exchange rate bore interest on a separate omnibus account converted into HUF until the end of the exchange rate fixing, then the debtor had to pay it. In case of CHF loans, the bank and the Government assumed the interest rate payments for an exchange rate of HUF/CHF 180 and 270 at 50–50%, and over HUF/CHF 270 the State assumed the entire redemption (including the capital payment).

Subsequently, we may say that this was the only debtor-saving construction, which was prepared with the collaboration of banks, by substantial state commitment.

5. 9. Final repayment at a fixed exchange rate – Act CXXI of 2011 on the amendment of certain acts related to home protection

Based on law, in case of final payment in one lump sum, the banks had to allow debtors to get out of the loan at HUF/CHF 180 and HUF/EUR 250 exchange rates fixed in the previous package serving to save foreign currency loan debtors. The following persons were eligible for final repayment:

- for whom the exchange rate applied upon disbursal was not higher than the fixed rate,
- whose loan was not cancelled by the bank,
- who submitted an application for final repayment by 30 December 2011,
- who undertook early repayment of a bridging or omnibus account, and
- the final repayment happened by the 60th day following the application.

The key argument of professional criticism against the Act was state intervention into private legal relationships. In connection with that, it is worth mentioning that according to the Civil Code a legal provision may only overwrite contracts in exceptional cases. And the phrase "exceptional" has identifiable content based on court practice. Accordingly, among other things, such a change has to take place in the objective circumstances following the signing of the contract, due to which the completion of the undertaken obligation would violate the rightful interest of either party. The change has to impact a wide range of society,

[23] This caused a problem in practice, since there was no such case when the Government would have provided government guarantee.

and it should be ensured that the intervention is necessary to achieve the objective, and the violation of other basic rights limited by completion should be proportionate. Although the exchange rate fluctuation can be considered as an external circumstance according to experts, theoretically all debtors should be aware of the option of exchange rate fluctuation itself when signing a loan agreement. This was separately addressed by the bank's contractual conditions, and the banks had clients sign a risk-taking declaration.

We share the professional view that exception must not mean the violation of property rights. However, the banks possess property right protection regarding loan capital. This means that, while the bank makes money on the loan, at the end of the duration it will certainly collect more money with the interest rates from debtors than the amount of the loan taken, while still enjoying protection. It was also concerned that, based on this, the Government might possibly pay damages to banks if the final repayment paid by the debtor at a discounted exchange rate did not reach the outstanding capital debt. Based on calculations, if the outstanding capital debt can be paid back by the debtors at a fixed exchange rate, the banks accrue loss between 15% and 35% on their capital liabilities.

The wording of the Act was not completely unambiguous. During its execution, the banks had to almost continuously request commitment and guidance. The realization of the construction was still accompanied by numerous subsequent legal disputes.

Based on my view, the Act was on one hand limited in its impact (it concerned not quite 170,000 loans) on the debtors who were still able to perform (in many cases by using their last reserves and taking a replacement loan), however, it did not help the insolvent debtors. On the other hand, it placed financial and mainly administrative burdens on the banking system.

It is also interesting that the scope of the Act applied to final repayments that could be completed based on " *Mortgage registered on a residential property in the Republic of Hungary*", in its letter dated 15 December 2011, the Hungarian Financial Supervisory Authority informed the banks of the following: according to their views "*the consumers can have the option to repay their debt at a fixed exchange rate even if the denomination in the property registry is not "social vacation home" or "vacation home", but it is indicated as "vacation building, weekend house, apartment, holiday house, or boat-house" clearly referring to its vacation purpose*[24]." Based on the above, those clients were also eligible for final repayment at a fixed exchange rate, whose loan collateral was provided by a property, which instead of "social vacation home" or "vacation home", had a "vacation building, weekend house, apartment, holiday house, or boat-house" denomination in the property registry.

5. 10. The establishment of National Asset Management – Act CLXX of 2011 on ensuring housing for natural persons incapable of meeting their payment obligations under their loan contracts

The basic idea of the National Asset Management (NAM) is that the Government purchases the properties of insolvent debtors from banks, who then in turn rent it back from NAM. The proposal of the Banking Association for solving the problem was already in front of

[24] Executive letter by the Hungarian Financial Supervisory Authority, 15 December 2011

the Cabinet in 2009. The proposal of banks was basically identical with the finally approved concept of the National Asset Management. The idea of the financial institutions was that those loans, which cannot be helped with banking tools (e.g. because the debtor lost his job, so he is not able to pay the lowered instalment rate either), should be assumed by a state organisation along with the concerned flat. The organisation can rent the property out as a social rental flat to the previous owner, so he does not have to leave his home.

Based on the law however, the purchasing conditions of the residential property were strict, and a social (means-tested) certificate was required for it. The NAM could only buy the property, if the purchase price (which was fixed as the percentage of the market value by settlement types) was accepted by the bank. In this case, the bank gave up on its claims above the purchase price. The owner signed a rental agreement with NAM and, as a tenant, had the opportunity to re-buy the property later.

The initial 5,000 properties were later extended to 25,000 based on the agreement signed with the Banking Association.

5. 11. Act XXXVIII of 2014 on the resolution of questions relating to the uniformity decision of the Curia regarding consumer loan agreements of financial institutions

5. 11. 1. Antecedents: Decision C-26/13 of the European Court

It belongs to the antecedents of the case, that the Curia initiated preliminary decision-making proceedings in connection with a specific consumer-related legal dispute with the Court of Justice of the European Union (EUC). In the EUC Decision C-26/13 dated 30 April 2014, the question of "*if the contractual conditions specifying the conversion rates, which are not negotiated individually in case of a loan which was denominated in foreign currency, but was actually disbursed in national currency and to be paid exclusively in national currency by the consumer, can be integrated under the concept of 'definition of the primary subject of the contract'?*" had a prominent role. In its decision, the EUC provided a fairly general answer to the question when it stated: the concept of "the primary subject of the contract" only extends on to such conditions, "*if the court submitting the question establishes based on the assessment of the nature, general system and stipulations, as well as legal and factual correlations of the contract, that the above mentioned condition defines the fundamental service of the contract, typical service as such", i.e. it returned it to the Curia for inspection. However, it declared as guidance, that "such condition, since it places financial obligation on the consumer that he shall pay the amounts derived from the difference between the selling and buying rate of the foreign currency during the redemption of the loan, shall not be considered as containing a 'pricing', which according to the unfair nature of the service provided by the lender as counter-service cannot be assessed based on Decree 93/13 article 4 (2).*"

The Decision of the Court of Justice of the European Union has been analysed by many people from many aspects. Of those I would first like to highlight the analysis of *Ákos Szalai*. He starts by saying that "*The first two questions of the Curia referred to how should these restrictions be interpreted: what does 'price', 'the primary subject of the contract', and 'clear and understandable' phrasing mean. At first glance, the fact that the loan has to be repaid according to the buying rate of the concerned foreign currency is a clear, understandable phrase* *specifying the counter-service undertaken by the consumer. The first and second instance however – contrary to the applicable references by the bank – still declared it unfair. ... The decision possesses the professional problems generally characterizing the consumer protection regulation. To understand it, one needs to know that this regulation was not derived from jurisprudence addressing contracts for thousands of years, but from economics modelling the fairly simple form of sales. … In reality service faces counter-service in contracts – and not an exogenous specific product against some (generally modelled as a single factor) price."*

"That is exactly why, when consumer protection separates price and remuneration (point 54), it tries to enforce quite a foreign model from the contract concept of law. This is well reflected by the decision as well. The Court of Luxembourg practically does not offer a test to decide which points of the contract should be considered as 'decisive for the relation of service price/quality' (point 52). It simply states that the definition of the exchange rate is not such (see points 52–58). To put it a bit more severely: it questions the clarity of such termination of the contract – and highlights the uniformity of the contract. The concept of primary service is less of a problem. Especially, if we identify it against the 'essence' with 'subsidiary-type' elements (point 50) as it appears in the Decision. Even though this distinction is known in other areas of civil law as well, it is not a coincidence that it by far does not have the same significance in Hungarian law as in the contractual rights in other countries. The fact that the separation of these elements is not always simple is also a reason for this. … the verdict does not suggest such an inspection (the average consumer test is not brought up by the verdict in connection with the separation of the contractual phrases, only by clarity in point 74), and the certain phrases should be separated not based on the assessment of the consumers, but the 'nature, general system and stipulations, as well as legal and factual correlations of the contract" (point 1 of the verdict)."[25]

In connection with the above, *Mónika Papp* examines the Decision of the European Court with the eye of a jurist: *"The Luxembourg Body provided many guidelines for the courts of member states to decide whether the stipulation similar to the exchange rate gap belongs to the primary subject of the contract, or not. It did so despite the fact that in point 37 the verdict established that the primary subject of the contract should be interpreted uniformly and independently in the entire European Union, with consideration for the correlations and the aim of the regulation, since its text does not contain a specific reference to the rights of the member states. In point 47 of the verdict however, the EUC highlighted that the primary subject of the contract should be interpreted with restrictions, as an exception from the system of contextual examination of unfair conditions. According to the highest interpretation of EU law, this exception covers only the basic services of contracts, those which specify the essence of the contractual relationship and that are not ancillary. With the separation of the basic and non-ancillary service, the condition of whether the parties negotiated the condition should not be considered, as the Directive shall only be applied to the not yet negotiated contractual conditions."*

"As a starting point, the Advocate General suggested that the condition should somehow, from a legal or commercial aspect, be a part of the definition of the substantial features of the contract objectively. In this sense, the court had to specify if the referenced condition constitutes a part of the services defining the contract in itself, by checking if in absence of this condition the contract

[25] Ákos SZALAI: *Kásler verdict of the European Court with an eye of a jurist.* MTA Social Sciences Research Centre Momentum-HPOPs Research Group. Available on the Internet: https://hpops.tk.mta.hu/blog/2014/05/az-europai-birosag-kasler-itelete-egy-joggazdasz-szemevel

would lose one of its fundamental features, or it is not possible to fulfil even with all the remaining contractual stipulations. The Advocate General's question was the following: 'If the establishment of transaction interest constitutes the essence of the loan agreement, what should a mechanism, which enables the lender to calculate the monthly interest rates based on the exchange rate of some foreign currency qualify as?' (point 58 of the initiative) In case of a mortgage-type loan agreement, where the property is insured by mortgage and is registered in foreign currency, according to the Advocate General most likely the primary subject of the contract includes the condition defining the exchange rates, since in absence of this condition the fulfilment of the contract is jeopardised. In an already concluded, similar British legal dispute the various level of courts arrived at different conclusions, whether the (excessive) fee charged by the bank in case of the unauthorized overdraft of the bank's loan amount belongs to the primary subject of the contract or not. As a petitioner, the Office of Fair Trading won a case both in front of the High Court and the Court of Appeal by stating that the excessive amount of banking fee is unfair (dishonest). The Supreme Court however decided without launching a preliminary decision-making procedure, independently, that since the banking fee belongs to the primary subject of the contract, therefore its dishonest, unfair nature cannot be examined based on the British regulation transposing the directive. (Office of Fair Trading v. Abbey National plc and Others [2009] UKSC 6, [2009] EWCA 116, [2008] EWHC 875 (Comm))."[26]

The above-mentioned opinions are cautious when they establish that the Decision of the EUC is based on rather shaky foundations. My personal view however – by completely accepting the contents of the analyses – is stricter than this.

Let us revisit the definition of foreign currency loans listed in the beginning of the study. From the definition of the concept, it is clear that the lender's services include the disbursal of the loan amount denominated in foreign currency according to the legal currency of the place of payment, whereas the debtors' counter-service is the payment of the loan amount denominated in the denominated currency, regardless of which currency the payment is rendered. Conversion between various currencies is a constructional condition and an immanent part of the parties consideration which is necessarily connected to the cost of conversion. The cost therefore – according to the concept definition – necessarily constitutes the primary subject of the contract, hence its unfair nature cannot be examined based on the Directive and the transposing national regulation. The conversion cost is not some kind of "fee" charged separately by the EUC as the compensation for a service, but it constitutes the primary subject of the contract.

At the same time, the verdict of the EUC stated that "the primary subject of the contract" only extends to such conditions, *"if the court submitting the question establishes based on the assessment of the nature, general system and stipulations, as well as legal and factual correlations of the contract, that the above-mentioned condition defines the fundamental service of the contract, typical service as such"*.

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26 Mónika PAPP: *Kásler verdict of the Curia - with the eye of a European jurist.* MTA Social Sciences Research Centre Momentum-HPOPs Research Group. Available on the Internet: https://hpops.tk.mta.hu/blog/2014/06/a-kuria-kasler-itelete-egy-europai-jogasz-szemevel

5. 11. 2. The uniformity decisions of the Curia

In accordance with the verdict of the EUC, the Curia shall (should) examine, based on the assessment of the nature, general system and stipulations of the contract, as well as its legal and factual correlations, whether the referenced condition specifies the fundamental and typical service of the contract. However, the Curia neglected the more detailed examination of these correlations.

According to point 1 of the civil law uniformity Decision 6/2013 of the Curia, there is no conversion in case of loan agreements denominated in foreign currency, only recalculation, for which the usual fee for currency conversion is not due. Due to the application of different exchange rates, the financial institutions accrue income not covered by consideration, and the consumers accrue an expense, which is unfair.

In contrast, although point 1 of the civil law uniformity Decision 6/2013 does not address unfairness contextually, but in general it implies that *"the parties specified the monetary debt of the lender and the debtor derived from the loan agreement in foreign currency (denominated currency), and both parties had to render that in forints (paid currency). With this type of contract the debtor became indebted in foreign currency by a more beneficial interest rate than HUF loans had in this period, consequently, he bears the impacts of the exchange rate fluctuation: the depreciation of the HUF results in increased payment burden for the debtor, and its appreciation in a reduced burden."*

In its uniformity Decision 2/2014, based on the individual case, the Curia made three observations:

1. The exchange rate risk – in exchange of a more beneficial interest rate – is borne by the consumer without limitation, is a contractual regulation constituting the scope of main service, the unfairness of which cannot be examined as a main rule. The unfairness of this regulation can only be examined and established, if for the generally informed, reasonably attentive and careful average consumer (hereinafter referred to as: consumer) its content was not clear or not understandable during signing of the contract, considering the text of the contract and also the information received from the financial institution.
2. The contractual provision allowing for unilateral contract amendment is unfair if it does not meet the principles listed in point 6 of the PK Opinion 2/2012 (10. XII.) on the unfairness of the unilateral contract amendment right listed in the general contract conditions applied by the financial institution in the loan agreement (the principle of clear and understandable wording, principle of itemised definition, principle of objectivity, principle of effectiveness and proportionality, effectiveness transparency, callable principle, principle of symmetry).
3. The application of different exchange rates is unfair, because there is no direct service provided to the consumer, therefore it means an unjustified cost for the consumer. These regulations are also unfair, since the economic reason for their application is not clear, not understandable and not transparent for the consumer. Instead of the buying and selling rates listed in consumer loan agreements denominated in foreign currency as conversion rates, the official foreign exchange rate of the MNB become part of the contract, in consideration of the disposing legal provision of the Civil Code of 1959 231. § (2).

In regards to the application of the exchange rate gap, the following can be established:

1. The exchange rate gap is always the difference between the buying and selling rate on the same day. It cannot be interpreted as the difference between the buying rate upon disbursal and the selling rate upon repayment.
2. The buying and selling rates are formed by the supply-demand conditions, similarly to the stock market rates. It is absolutely not necessary for the bank in charge of foreign currency trading to index them to each other and define a fixed exchange rate difference (exchange rate gap). The exchange rate gap during the signing of the contract does not mean that the same difference will be applicable upon repayment. The consumer cannot conclude in any form how the instalment rates will develop on certain instalment dates. The exchange rate gap may even change on the day following the signing of the contract due to market fluctuations.
3. No contract or legal provision mentions the exchange rate gap. It follows from the APR decree[27] formula that with the APR calculation the buying and selling rate applicable on the date of contract should be taken into account, but then it should not be paid by the debtor (the known value), unlike the considerable, actually payable real costs during APR calculation (e.g. value assessment fee). The difference in the buying-selling rates for the debtor is not a cost to be paid on the date of contract, i.e. not an actual cost. The APR helps to compare the prices of different banks and banking products, and is a tool supporting decision-making for consumers, an indicator, which is only authoritative for one single date, the date of contract (but is not a cost!). Its extent – as mentioned in the previous point – might even change on the day following the date of contract (in a strictly normative way), so it is almost certain that the debtor would not have to pay the cost listed in the APR of the contract date in the first and the next instalment rate (and only then).
4. Based on this, all factors taken into account during the APR calculation should be considered as cost and separately listed in the contract, since they have already been expressed in the APR. With this approach, the debtor could rightfully believe that he should pay these factors in addition to the APR as extras. With this approach all other costs taken into account during the APR calculation should be listed by item (in addition to the APR), and the function of APR is to provide a summarized indicator for the consumer to decide which product to choose.
5. According to the EUC verdict, the APR does not have a meaning that could not be interpreted from the legal provision to help the debtor in establishing the amount of his future debt. According to law, the role of APR is only to make different banking offers comparable, so the consumer knows the gross price of the product.
6. Upon redemption, the debtor does not pay the exchange rate gap, but the counter value calculated with the sales price. The exchange rate gap, with special regard to the content of point 2, does not influence the debtor's payment obligation by any means.

[27] Government Decree 83/2010 (25. III.) effective at the time on the establishment of the Annual Percentage Rate of Charge, its calculation and publication..

7. If the rules regarding unilateral contract amendment were authoritative for the exchange rates and consequently the exchange rate gap, the amendment would have to be announced 15, or 60 days in advance, which is obviously impossible on the foreign exchange market.

5. 11. 3. Act XXXVIII of 2014

Based on the civil law uniformity Decision of the Curia No. 2/2014, the Parliament approved Act XXXVIII of 2014. The Act pointedly *"does not declare new financial legal regulations, and does not establish new legal principles regarding the consumer credit, loan and financial lease agreements, it only codifies the interpretation of the law of the Curia."*

The Act declared the application of the exchange rate gap as unfair, and established the protection of unilateral contract amendment unfairness. In case of applying the latter, it created an opportunity for the financial institution to prove the unfairness of the applied unilateral amendments in a separate lawsuit, and compliance with the principles stipulated in the PK Opinion 2/2012. (XII. 10.) point 6.

In addition to the above, the Act established the separate rules for legal procedures aimed at overthrowing this unfairness protection, the rules to be followed in pending foreign currency loan lawsuits and the separate rules of related enforcement proceedings. It referred the rules concerning the settlement between consumers and financial institution to a separate act.

5.12. Act XL of 2014 on the rules of settlement

According to the principle of the so-called Settlement Act created based on Act XXXVIII of 2014 in case of an unfairly charged exchange rate gap, the financial institution has to settle with the consumer by applying the official foreign currency exchange rate published by MNB.

The Act regulated the settlement of unfair amounts charged based on the exchange rate gap and the unilateral contract amendments. The Act pronounced that unfairly charged amounts shall be considered as early repayment.

Additionally, the Act stipulated special rules to adapt to certain debtor-saving legislation (early repayment, National Asset Management, exchange rate cap, bridging loan), as well as suspended legal or enforcement proceedings.

5. 13. Act on conversion into forints

Following the legal uniformity Decision of the Curia No. 2/2014, the Government's intention regarding the mandatory conversion of foreign currency loans to forints was notable. The Decision of the Curia made it clear that the exchange rate risk encumbers the debtor. The Ministry of National Economy announced in November 2014: *"The accountability of banks and the conversion of foreign currency loans into forints is underway in accordance with the previous decision of the Government. As they promised, the Cabinet phases the foreign currency loans out of the market in three steps: first, after the decision of the Curia, it fixed the method of accountability. Afterwards, the banks shall settle with their clients. In the third step, the foreign currency loans are phased out from the market. With the settlement of the foreign currency loan problem, the*

Government acted in the utmost consideration of the Curia's Decision, ensuring complete legality of the process, therefore the conversion into forints may also take place based on the Curia's Decision."[28]

The basis for the conversion into forints was provided by the average exchange rate of the period since the Curia's decision, or the daily MNB exchange rate as of 7 November 2014. From these two rates, the bank was obligated to apply the more beneficial exchange rate for the foreign currency loan debtor. In case of debtors with CHF loans, it meant HUF/CHF 256.5, and in case of those with EUR loans, a HUF/EUR 309 conversion rate.

For a manoeuvre of such magnitude great determination, very thorough planning and coordinated collaboration was needed. Furthermore, discretion in regards to timing and the conversion rate. If the details were leaked, a speculation attack could have easily undermined the largest Hungarian financial transaction of all times.

A foreign currency loan volume of HUF 2,700 billion (approx. EUR 9 billion) had to be converted into forints, i.e. the banks had to pay the foreign exchange (resource) behind the loans back to their lenders. To put it simply: during the phasing out of foreign currency loans the banks had to pay out a lot of forints to buy euros or Swiss francs and close foreign currency loans. The debts, of course, remained in the system and in the books of banks, but now in forints. If however, the banks simultaneously sold HUF 2,700 billion on the market, it would have caused the unforeseeable depreciation of forints. Therefore, the foreign currency resource for repayment was provided by MNB (so the banks did not have to get it from the free market), at a fixed rate (it was published on 9 November 2014, that in accordance with the agreement with banks the conversion into forints was carried out on the exchange rate on 4 November), to prevent speculation attacks.

The conversion into forints was carried out in two steps. First, the loan agreements denominated in foreign currency with a mortgage registered on the property were converted – including the mortgage registered as independent collateral – with the settlement record date of 1 February 2015.[29] After this, based on a separate act,[30] the conversion of loan agreements denominated in other foreign currency were also converted into forints. The Government and the Banking Association signed an agreement on 19 August 2015 on the conversion of consumer foreign exchange credit and foreign currency denominated loans into forints, and based on this the government bill was submitted in mid-September 2015. The conversion into forints took place on the foreign currency market exchange rate on 19 August 2015, and the resource for this was provided by MNB.

According to the Act, the financial institutions were obligated to prepare the text of amended contracts by 15 December 2015 as loan agreements with annuity instalment rate, and also send the text of the amended provisions to the concerned principal debtor.

[28] MTI, 09 November 2014, furthermore: https://www.portfolio.hu/finanszirozas/hitel/bejelentettek-ezen-az-arfolyamon-forintositjak-a-devizahiteleket.206185.html

[29] Act LXXVII of 2014 on the settlement of questions regarding the modification of foreign currency of certain consumer credit agreements and the rules on interest rates

[30] Act CXLV of 2015 on the settlement of questions regarding the conversion of claims derived from certain consumer credit agreements into forints

6. Progressive (proactive) legislation

6. 1. "Fair Banking" Act – Act LXXVIII of 2014

The Act made the obligations of financial service providers engaged in retail banking services and the rules of contract signing and amendment unambiguous.

The amendment of the Credit Act incorporated into law concerns the following main questions:

- making the informational obligation prior to contracting more efficient;
- new provisions regarding the amendment of the loan agreement;
- authoritative rules in regards to the free cancellation of the loan agreement by the consumer;
- special regulations concerning loans denominated in foreign currency;
- rules regarding the change over to the new contractual conditions;
- Regulations about the amendment of Act XL of 2014 on accountability.

According to the law amendment, before signing the loan agreement the lender and the credit mediator are obligated to inform the client with clear, transparent and representative examples, based on which the consumer may assess whether the loan to be utilized meets his needs and financial capacity. During this process, the lender and the credit mediator provide the consumer with information required to compare various offers in order to enable the consumer to make a grounded decision on the possible signing of the loan agreement.

A loan with maximum 3-year duration can be provided by

a) fixed interest rates or
b) floating rate indexed to the reference interest rate published on the website of the MNB and fixed interest surcharge

during the entire duration and defined in the loan agreement. The interest rate conditions of this loan many not be amended unilaterally and unfavourably for the consumer.

A loan with over 3-year duration can be provided by

a) floating rate indexed to the reference interest rate published on the website of the MNB and fixed interest surcharge during the entire duration or at least in 3-year interest periods,
b) loan interest fixed in at least 3-year interest periods, or
c) fixed interest rate

during the entire duration and defined in the loan agreement.

In case of loans with over 3-year duration, the financial institution shall fix the loan interest, whereas in case of loans indexed to the reference interest rate – floating rate – the interest surcharge shall be fixed in advance in at least 3-year interest periods.

With those loans, where the loan is indexed to the reference interest rate, i.e. that have floating rate, the interest surcharge amending indicators should be monitored. They include the mortgage credits that are converted into forints. In case of these loans, the interest surcharge – the delta of the loan interest and the reference rate – is fixed during the interest period. The interest rate of the loan fluctuates during the interest period, by being adapted to the duration of the reference interest rate.

The reference interest rates and indicators are calculated and published by MNB. Financial service providers may use their own interest rate changing and interest surcharge indexes, or reference interest rates, if MNB has pre-approved them. The indexes and their values can be checked on MNB's website.[31]

In addition to the interest rate, the lender may only establish and amend such cost unfavourably for the consumer, which – in proportion to its growth – was listed in an itemised way in the contract. A further condition is that the cost should have arisen during the contract signing or amendment and communication with the consumer directly in the consumer's interest, in connection with the service provided by a third party, and in a transparent way for the consumer.

In addition to the interest rate, the lender may only establish the payment of a fee (with certain exceptions listed in law) if it is listed in the loan agreement in an itemised way, and is in connection with the contract signing, contract amendment and termination, or the transaction costs. The lender may only increase these fees up to the level of the previous year's consumer price index published by the Central Statistics Office. The lender may amend the cost as it arises, and the fee once per year with the effective date of 1 April. The Act maximises the extent of the disbursal and availability fee as well.

The Act contains detailed regulations regarding the content of the amendments and the deadline of the previous information obligation.

The Act guarantees the opportunity of loan agreement termination both for the consumer and the credit institution based on specified rules, and stipulates its detailed rules.

In regards to foreign currency loans, the law amendment also pronounced the obligatory application of the risk exposure declaration already incorporated in the Credit Act earlier, and the rule of applying the mandatory central rate.

The Fair Banking Act can be considered a proactive regulation, since it influences and clarifies the rules of providing consumer loans.

6. 2. Debt brake regulation – MNB Decree No. 32/2014 (10. IX.)

In order to prevent excessive retail indebtedness and the booming of foreign currency lending again, MNB created a new macro-prudential regulation. The debt brake regulation, which came into effect on 1 January 2015, fundamentally consists of two main pillars: the introduction of the loan-to-value and the income-to-instalment index.

The regulation, on one hand, specifies the value of exposure upon the assessment of the credit application, the so-called loan-to-value index (LTV) by loan purpose. In case of secured loans (e.g. mortgage credits), the loan-to-value (LTV) index limits the size of borrowable credit in ratio to the collateral (value of flat).

With loans provided by mortgage collateral registered on the property

- in HUF the value of exposure upon the assessment of the credit application must not exceed 80% of the property's market value, or 85% in case of a financial leasing,
- with EUR-denominated or EUR loans 50%, or 55% in case of a financial leasing,
- 35% of loans denominated in other currency, or 40% in case of a financial leasing.

[31] https://www.mnb.hu/fair-bank/kamatfelar-valtoztatasi-mutato

In case of loans provided for vehicle purchase

- in HUF the value of exposure upon the assessment of the credit application must not exceed 75% of the vehicle's market value, or 80% in case of a financial leasing,
- with EUR-denominated or EUR loans 45%, or 50% in case of a financial leasing,
- 30% of loans denominated in other currency, or 35% in case of a financial leasing.

The income-to-instalment index (ITI) limits the maximum repayment burden that could be imposed on a client to a definite percentage of their regular, legal income, while it moderates their indebtedness.

The fundamental aim of the debt brake regulation introduced by MNB is to prevent the excessive indebtedness of households and the booming of foreign currency denominated loans again. The income-to-instalment index (ITI) tries to offset the negative impact of foreign currency denominated loans and to steer demand towards loans denominated in HUF.

If the clients' or in case of co-debtors, the taxpayers' total certified monthly net income is less than HUF 400,000, the ITI value upon credit assessment may not exceed

- 50% in case of a HUF loan,
- 25% in case of a EUR or EUR-denominated loan,
- 10% in case of foreign currency loans provided in another currency.

If the clients' or in case of co-debtors, the taxpayers' total certified monthly net income equals or exceeds HUF 400,000, the ITI value upon credit assessment may not exceed

a) 60% in case of a HUF loan,
b) 30% in case of a EUR or EUR-denominated loan,
c) 15% in case of foreign currency loans provided in another currency outside of b).

According to the new ITI rules, in case of mortgage credit applications received after 1 October 2018, which have more than 5 years duration – depending on the duration of the loan's interest period – lower than the current ITI limits shall be applied. The amended provisions also ensure that in case of an unfavourable interest rate change, the households should have proper income reserves. People with higher income – due to their higher redemption ability – can still borrow a loan by higher monthly instalment rates. Considering the dynamic salary increases notable in the recent years and hopefully continuing in the future, the regulation allows for taking higher ratio instalment rates in case of HUF 500,000 monthly income from 1 July 2019 (instead of the previous HUF 400,00).

ITI rules for new mortgage credits in HUF from 1 October 2018

Monthly net income	Interest period		
	Varying interest – 5 years	5 years – 10 years	10 years – until the end of the term
Below HUF 400,000 (HUF 500,000 from 1 July 2019)	25%	35%	50%
HUF 400,000 HUF (HUF 500,000 from 1 July 2019) or above	30%	40%	60%

Source: https://www.mnb.hu/sajtoszoba/sajtokozlemenyek/2018-evi-sajtokozlemenyek/az-mnb-az-adossagfek-szabalyok-modositasaval-is-osztonzi-a-fix-kamatozasu-lakashitelek-ternyereset

Besides the above, the MNB regulation also supports the moderation of the interest rate risk of already borrowed loans by not having to apply the debt brake rules for contract amendments and loan replacements, unless the new loan's interest period is shortened.

The Fair Banking Act and the debt brake regulation follow similar considerations as the recommendations issued by the Poland banking authority in Poland before and at the beginning of the crisis.[32] They were able to efficiently prevent the excessive penetration of foreign currency loans in Poland, although in a different economic-legal environment.

In addition to the referenced regulation, the mortgage-financing-compliance index, serving as the resource for long-term retail credits, and long-term interest swap transactions and mortgage debenture purchasing program applied by MNB can also be considered as regulations with positive impact. They promote the penetration of mortgage credits provided by long-term interest periods. The Consumer-Friendly Housing Loan rating system serves the strengthening of trust towards lending financial institutions. Information regarding its detailed rules exceeds the scope of this study.

7. Historia est Magistra vitae

Historia est magistra vitae – said Cicero. Indeed, it is worth contemplating on what we did wrong with foreign currency loans, and whether the "adventure" embittering the lives of several hundred thousand people could have been avoided. Did we do everything, and did we do it efficiently enough to manage the problem? What are the lessons learned for the future and can similar situations be prevented, if so, how?

7. 1. Reasons for the penetration of foreign currency loans

When we investigate these questions, first and foremost we have to explore what led to the population's mass indebtedness in foreign currency. For this, we must schematically review

32 HUDECZ: i.m. 366-369.

those theoretical items, which prompt the consumers under market circumstances to take loans in another currency other than one in which they generate their income.[33]

The answer seems obvious: the foreign currency loan had substantially lower interest rates than HUF loans at the given time, hence why consumers chose foreign currency loans. It might seem like a simple and logical explanation, however it is worth examining deeper correlations. If someone borrows a loan with income in HUF by taking a risk related to the foreign currency loan, why does he take this substantial risk?

The most often quoted reason is that consumers underestimated the risk accompanied by the exchange rate fluctuation, or simply ignored it. There might be several reasons to this seemingly irrational consumer attitude. The most typical is normally the moral risk, when the consumer trusts that the Government will intervene in an extreme case to prevent bankruptcies of banks and social tensions. A reason could be that consumers do not consider that the considerable open foreign currency position increases the vulnerability of the country, which generally raises the price of loan products (not only of the foreign currency loans). In addition, the uncertain or discredited economic policy and the high and fluctuating inflation level of the country are mentioned, as well as in which environment a tool suitable to fight off the real interest fluctuations could be the foreign currency loan.

"The clarification of reasons is not autotelic. To solve the problem of foreign currency lending (wherever it is a problem,) it is inevitable to clarify its cause. Different causes require different handling methods. If, for example, the main cause is the lack of credibility of the economic policy institutions, then the limitation of dollarization by administrative or surveillance tools does not address the root of the problem, therefore it can only imply long-term, sustainable success in a limited way (let us not forget that foreign currency lending is not always "bad", consequently limiting it is also not necessarily "good" or successful). However, if the cause is the lack of information provided to the credit borrowers, wide-scope information campaigns might help, whereas if the moral risk or the external factor is the key cause, then regulation and the internalization of costs could be the right tool for managing the problem."[34]

Based on practical experiences the fundamental pre-condition for foreign currency lending is free capital flow, and hence the abundance of inexpensive foreign currency resources. During financing via the banking system however – unlike working capital or portfolio investment – due to the essence of the construction, the exchange rate risk is inherent to the credit borrower.

The lack of long-term national resources helps the penetration of foreign currency lending. A very significant factor could be the loose and unpredictable fiscal policy, which due to excessive indebtedness is accompanied by substantial financing need. This, in turn, increases the risk premium of financing, and on the other hand, the state financing requirement forces other market players out of the credit market.

In case of a conscious consumer, the interest rate gap does not necessarily influence the consumer's decision (based on the deliberation of risks). Due to the low-level financial culture in post-socialist countries, the consumers faith in unchanging exchange rates shifted demand towards foreign currency loans with substantially lower interest rates. It is certainly in the interest

[33] The analysis was prepared based on the quoted work of *András Hudecz.*

[34] HUDECZ: i. m. 356.

of lenders to sell their credit products to well-informed and creditworthy consumers, however one-time thorough information (even by the thorough and plain wording of risk exposure declarations) is not able to supplement such insufficiencies of the financial culture prior to lending. At the same time, we cannot deny that part of the lending banks did not completely disclose the reason for the exchange rate difference or the risks, consequently the interest of consumers was shifted towards "cheaper" foreign exchange credit products to increase their market share.

The consumer's faith in unchanging exchange rate can be increased, on one hand, by the banking practice that presents the exchange rate risk backwards based on timelines. It is only elevated by the central bank's routine, which keeps the exchange rates permanently at the same level (although their amendment would be justified), and also the continuous and long-lasting appreciation of national currency which might create the feeling in the consumer that the instalment rate of the foreign currency loan is continuously decreasing.

If we investigate the above theoretical and practical considerations, we have to say that in the beginning of the 2000s, in Hungary, all conditions were simultaneously met.

As I wrote in the beginning of the study, Government Decree 88/2001. (15. VI.) § 5 (followed by reinforcing Act XCIII of 2001) enabled free loan borrowing without foreign exchange limitations for national residents. Without limitation meant that the consumer could practically borrow a foreign currency loan with equal conditions to the HUF loans, not counting the exchange rate risk. It was not a problem for a long time, since based on Government Decree 12/2001. (31. I.) the subsidised housing loans denominated in HUF were able to satisfy the population's needs. Moreover, the unlimited housing subsidy really increased the appetite of the population for loans (the previous decade's irrational municipality rental flat sales program, which created an unhealthy housing structure played a role in this). Therefore within a short time, at the end of 2003, substantial restrictions had to be introduced in interest rate subsidies.

Today it is difficult to clearly establish the role the launching of retail (housing) loans played in the preparation of foreign currency loans, the booming, then retaining of the state subsidized interest rate program, the authorization of foreign currency swaps for national citizens, as well as the expansion of the intervention range of the HUF exchange rate. These steps and circumstances either happened simultaneously, or followed each other very quickly. The viewpoint of *András Hudecz* might be acceptable,[35] according to which the complete elimination of foreign currency restrictions played a minor role in this, since at the EU accession of Hungary they would have been eliminated anyway, and foreign currency lending only started to really boom afterwards. I believe foreign currency lending could have been held back on the supply side.

The economic situation became quite uncertain during 2003. The monetary and fiscal policy followed substantially different strategies, the exchange rates were extremely volatile and the interest rate gap between the HUF and EUR increased by more than 6 percentage points by the end of the year compared to the mid-year situation. The fiscal policy was overspending for years since 2001, and the monetary policy in an orthodox way considered the stability of the exchange rate as its single task, subordinating everything else.

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35 HUDECZ: i.m. 384.

It is important to highlight those circumstances which also strengthened belief in foreign currency lending. On one hand, the outlook was very (excessively) optimistic in the world and in Europe both from a political and economic level. The cold war had ended, regime change had been carried out in ex-socialist countries, the accession negotiations to the European Union had begun, and accession was within reach. This straightforward development enticed with the hope of creating a new Europe. In addition to the harmonization of institutions, this would have been accompanied by the hope of economic integration, and, as part of that, the hope of introducing the euro as means of payment within a reasonable time. In the middle of 2003, the Government placed the target date for the introduction of the euro at 1 January 2008. Under such circumstances, the risk of borrowing a foreign currency loan seemed remote to the population.[36]

So by the end of 2003, the legal, economic and social system of conditions for foreign currency lending was available in a cumulated way with all known elements. However, we have to emphasize that foreign currency lending is not "bad" or "good" in itself, and its appearance in Hungarian lending practice is not detrimentally harmful or beneficial. Given a proper regulatory environment, it can effectively support the satisfaction of consumer needs. Typically, despite its penetration, the ratio of problematic foreign currency loans was not greater than that of HUF loans up until the Great Recession. We can much rather say that none of the stakeholders of the construct: neither the contracting parties, consumers and lenders, nor the regulatory state creating the environmental conditions were prepared for managing such a banking product. They did not recognize the impacts and dangers of foreign currency lending.

András Hudecz mentions that fundamentally it is about a phenomenon, which was already known in other parts of the world, although in a partially different social-economic environment. This so-called "dollarization", which in a simplified way means that the economic stakeholders of the given country are unable to access sufficient credit in their own national currency for some reason, so they become indebted in a more stable and liquid foreign currency. The phenomenon was quite prevailing in Latin America and Eastern-Asia (this has also partially contributed to the Asian crisis), where typically the USD was the stable foreign currency. This is where the name comes from, which by now does not only mean indebtedness in dollars, but also in all other foreign currency.[37]

7. 2. Hungaricums

In addition to the lack of regulation, there were however two specifically Hungarian conditions, Hungaricums, which led to aggravation of the problem (although they were not only connected to foreign currency loans).

This was, on one hand, the lack of a positive list debtors' registry fundamentally necessary to prevent excessive debt, based on which the lender could assess the consumer's creditworthiness a

[36] An extraordinarily good and precise summary on the optimistic public atmosphere that emerged by the 2000s, followed by the measures that were created during the subsequent crisis by TOOZE, Adam's book titled: *Crashed: How a Decade of Financial Crises Changed the World.* Penguin Books Ltd. Kindle Edition (First published in the United States of America by Viking, an imprint of Penguin Random House LLC 2018. First published in Great Britain by Allen Lane 2018) recently published.

[37] HUDECZ: i.m. 352.

lot more precisely and carefully. With this, the excessive lending for the most problematic clientele could likely have been avoided. The banking sector recognized the problem early enough, and from 2002 on urged the creation of such a database. This view was also shared by the competent ministries. The prevailing data security commissioners however kept hindering the creation of the database by referring to data security concerns. In my opinion, even at the first signs of the crisis, the commissioner on data security and his office did not understand the importance of creating a positive list debtors' registry as soon as possible. The creation of the database in 2011, full of compromises, was no longer able to prevent the over-lending of foreign currency loan borrowers.

The other, specifically Hungarian, feature was the question of how to regulate unilateral contract amendments. The report of the Várhegyi Committee pointed out the insufficient regulation of the question and, based on professional criteria, correctly emphasized the importance of self-regulation by banks. The commenced self-regulation by banks exposed a lot of interesting circumstances. It could have provided a legal and banking foundation to establish such a regulatory framework, which would have been able to settle this question with market tools and in a fair way for the consumer, clearly and understandably, specifically as a tool of sustaining contractual balance. The opportunity for an efficient and mutually complementary connection of self-regulation and legal regulation also presented itself here in the most obvious form. In contrast, based on the initiative of the Office of Economic Competition, a normative text was created from an idea which was previously professionally criticized and was proven to be unconsummated later. Subsequently, the opportunity of unilateral contract amendment became the symbol of the unfairness of banks, and its real economic justification was not recognized.

In addition to this, the foreign currency loan proved to be a remarkably successful product in retail lending. By 2008, some 70% of new retail loans were in foreign currency. Although MNB, from 2001, kept drawing attention to the dangers of foreign currency lending in its yearly stability reports, and the Hungarian Financial Supervisory Authority also informed about the risk, from the regulatory side the only measure that can be considered as a substantive step was the application of the mandatory risk exposure declaration introduced in 1 January 2005. We must note that during this period the two organisations operated as separate institutions, and neither had legislative opportunity in the concerned field.[38] Still, the importance of such limited opportunities and their market impact is well indicated by the joint recommendation creating awareness of the elevated risk of JPY loans in February 2008. In this, the banks were recommended to show how a 20% exchange rate shift and a 1-percentage point instalment rate change would affect the instalment rate. As a result of the recommendation, the banks cut back on JPY lending. It probably would have been useful to issue such a recommendation earlier and for other foreign currency loans as well.

[38] According to Act LVIII § 60 of 2001 on the Magyar Nemzeti Bank the provision establishing the decision-making power of MNB was limited in the examined period (base interest rate, reserve rate, cash flow, processing, settlement turnover, coin issuance, central bank information system). According to Act CXXXV § 12 of 2007 on the Hungarian Financial Supervisory Authority, the Authority was entitled to issue recommendation containing the foundations of its legislative practice. The recommendation however did not have mandatory power regarding the organisations and persons belonging to the competence of the Hungarian Financial Supervisory Authority, and its purpose was to increase the reliability of legislation.

7. 3. Summarizing the lessons learned until the Great Recession

1. First, prior to implementation, it would have been necessary to carry out research and inspections to learn the characteristics and risks of the product. It should have been examined whether similar products already existed on the market, and what kind of advantage-disadvantage it had both on a macro-and microeconomic level.
2. The most supportive solution for managing the exposed risks should be selected. When selecting the handling method, the opinion of experts from both the Government and economic sphere should be widely taken into consideration. It is necessary to assess the kinds of questions that can be solved by the self-regulation of the economy, and where legislation is required. The most efficient solution can be found by aligning self-regulation to legislation.
3. It is extremely important to create a balance between fiscal and monetary policy to create proper professional solutions, and to prevent the vulnerability of the Government due to the crowding out effect of governmental overspending[39] and high deficit.
4. The tight cooperation of regulatory authorities (central bank and supervision) is required in risk exposure and management. It is necessary to ensure binding regulatory powers (legislation) for the more efficient completion of tasks. In absence of that, an influence on the market stakeholders can be made by issuing joint recommendations.
5. For the sake of creating general lending safety and the prevention of excessive debt of consumers, a positive list debtors' registry needs to be prepared.

7. 4. Lessons learned during crisis management

From the autumn of 2008, due to the impact of the crisis – considering the tightening of resources –, lending (including foreign currency lending) significantly dropped without any separate administrative measures. With the fluctuation of exchange rates, the burdens of debtors boomed, the value of collateral real estate dropped, and unemployment suddenly increased. Therefore, the sustainment of solvency and willingness to pay by debtors, the rescheduling of loans and the application of payment moderation took on priority status in banking activities. With this, the banks were also looking for the opportunity to cooperate with the Government by means of their limited tools. Besides the common viewpoint and payment moderating programs emerging in the numerous successful negotiations, unfortunately, there were less successful aspirations as well, such as for example the legislative regulation of the right of unilateral contract amendment.

[39] The crowding out effect in simplest terms: if the Government issues government securities to cover the state deficit, it ties up such private savings, which would have financed private investments. See: http://www.econom.hu/kiszoritasi-hatas/ Product purchases by the Government has a crowding out effect. The crowding out effect caused by budgetary overspending is neutralized by the monetary policy. With the help of the tools of monetary policy, the central bank can regulate and influence the money supply and/or interest rate on the market. If, as a result of the central bank's measures, the monetary supply increases, the money supply available for asset keeping also increases. Due to the increasing money supply, the interest rate declines. Such an intervention is called expansive monetary policy. Should the central bank decide on reducing money supply, as a result of the declining money supply, the monetary market is balanced by a higher interest rate. The increase of the interest rate moderates investment demand, therefore the balanced income decreases. Such a monetary policy is called restrictive monetary policy.

The rules of the Code of Conduct approved afterwards were created based on best banking practice with the collaboration of the Hungarian Financial Supervisory Authority and the Ministry of Finance along with the professional support by banks. The rules of the Code of Conduct later served as the basis for legislative regulation. This collaboration could have been the example for the coordinated application of self-regulation and legislation.[40] Act CLXII of 2009 on consumer loans was also created by substantial professional banking support, the Government Decree on prudent retail lending and the amendment of the Credit Act on the regulation of intermediary activity.

I perceived that from 2010 the Government's practice has changed, both in their communication and in professional cooperation. Many times the announcements on governmental intentions took place in the press first followed by legislation, often without asking for the opinion of professional entities, or with their apparent hearing. This can also be attributed to the fact that, during this period, many laws had to be amended retrospectively – at least once, but rather several times – in order to ensure execution ability.

In connection with foreign currency loans, so-called debt relief or home-saving legislation emerged. As I have already mentioned, based on the study of *András Hudecz,* for the substantive solution of foreign currency lending-related problems, the cause of the problem has to be first understood, and the proper tool selected for it. In many cases, however, the law was not made to eliminate the cause of the problem, only to retrospectively treat its symptoms. It was also notable that the prepared provision regulates a phenomenon which has already been solved on the market, so it resulted in the re-regulation – correctly or incorrectly – of an already formed situation (e.g. Government Decree 361/2009. (30. XII.) or Act XCVI of 2010), forcing the market stakeholders to adapt. In many cases, legislation was also accompanied by "detrimental side effects".[41]

In this question, the opinion of Dan Ariely, Professor of Psychology and Behavioural Economics at Duke University, USA, should be considered as a guideline:

> *"… when we plan systems, especially, if we do it at a legislative level, we have to solve very complex problems and we can never precisely predict the outcome of a new rule.. We can never see the consequences of our changes in advance, hence sometimes people's lives might be compromised."*[42]

From a banking perspective, the communication that was extremely harmful was that which criminalized foreign currency lending from the start and introduced the impacts of

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40 It is altogether a different question, that legislation did not consider the provisions of the Code of Conduct –since the Code of Conduct was not a legal provision – in any form when passing justice. Regardless, that it was prepared based on a governmental initiative, the Supervisory Authority and the ministries were actively involved in creating its content, and the normative text of the Credit Act, effective from 2010, also specifically disposed of the consideration of its rules, and the majority of its provisions were subsequently integrated in the effective legal provisions of the time. This however does not show the difficulty of the aligned application of self-regulation and legislation, much rather the problem of judicial and supervisory legislation.

41 Such was the elevation of moral risk, the violation of *pacta sunt servanda* (https://index.hu/velemeny/jegyzet/2009/03/20/bank/), the destruction of trust in banks (https://www.penzcentrum.hu/hitel/oriasi-bizalomvesztes-a-bankoknal.132330.html), or typing up substantial banking resources for "debt relief"(administration, IT, labour).

42 *"A bad financial decision today might haunt us for decades" – interview with Dan Ariely.* https://fintechzone.hu/ha-ma-rossz-penzugyi-dontest-hozunk-az-evtizedekig-kiserthet-minket-interju-dan-ariely-vel/ (download: 09. 07. 2018.)

the crisis as if they were exclusively the consequence of the unfair behaviour of the lending banks. To get a fine-tuned opinion, it is worth quoting the standpoint of *Sándor Csányi*, the President-Chief Executive Officer of OTP Bank disclosed in May 2010:

> *"I believe that it is not necessarily the banking system which is at fault, or it is not primarily the banking system which is responsible for the fact that debtors, including forint debtors with HUF and foreign currency loans, are in a more difficult situation than what they hoped when they borrowed the loan. I believe it is not the banking system, because when the borrowers of foreign currency loans took out the loans five years ago, the exchange rate of HUF was fluctuating around 230–240–250 compared to the EUR, and today it is over 270, and it has been weaker, therefore the amount of debt denominated in forints has increased. This is not the fault of the banking system. This is obviously the problem of irresponsible budgetary management over recent years, maybe with the exception of 2008.*
>
> *- Is this a governmental failure?*
>
> *- I think it is primarily a governmental failure. That is also why I did not understand when the Government tried to save the debtors of foreign currency loans from the banking system at the time. The debtors of foreign currency loans should have been saved from the given Government at the time when the approximately 10% budgetary deficit led to a weakening trust in Hungary and in the Hungarian currency, consequently, the currency depreciated and the debt denominated in forints increased. The banking system can also not be blamed for the Government, the social Government, introducing the state subsidy for foreign currency loans and housing loans in foreign currency. Previously, they only subsidized loans in forints, i.e. it was worthwhile for the credit borrowers to become indebted in forints, and the subsidizing of foreign exchange credits, I think, decisively took place in the interest of foreign banks, otherwise against OTP, since they wanted to "extend competition" and reinforce it on the retail market, as OTP was previous lending in forints, therefore we only switched to foreign currency loans a year later, when our market share was rapidly deteriorating and we had no other choice. So altogether, the Government promoted foreign currency loans, had a bad economic and budgetary policy, and thirdly, we should mention the monetary policy as well, because if the forint had not been excessively over-appreciated, then one euro would not have cost HUF 230 when the debtors borrowed the loan, but 260–270, they would have considered whether to be indebted in forints or in foreign currency, and even in case of the depreciation of forints, their loan amount would have only increased at a much smaller degree."*[43]

The approach that was widely spread in the press was not emphasizing moral risk as one of the main reasons for the penetration of foreign currency lending, but almost exclusively the unfair proceedings by banks. Beyond the fact that communications contributed to the prolongation of the unsettled situation, it caused more harm by dismounting trust in banks. The banking industry operates fundamentally based on trust, it relies on the trust of clients,

[43] Interview with Sándor Csányi -" hír TV" (news channel): "Kontraszt" (Contrast), 16.05.2010

both on the resource and the asset side. The lack of trust can result in the weakening of the entire banking system, which is very difficult to re-establish later.

When assessing the attempts targeting the saving of debtors in distress, many people pointed out that the lending risk in the system is permanent, cannot be reduced by administrative measures, it can only be re-distributed between the three stakeholders at most. Hence, that is why certain rescue attempts – let us disregard their legality for now – only distributed risk-taking, usually against one of the stakeholders, the banking system (this is why the emerging situation had to be criminalized), but they were not and could not be used to solve the problem.

The system-level risk in foreign currency lending (incremental and stock) was eliminated, on one hand, by the establishment of the income-to-instalment index (ITI), and on the other hand by the conversion of loans into forints in 2014 to 2015 (which was proposed by *Surányi* already in 2011 and 2013). With the application of the fixed exchange rate, however, the debtors bear the instalment rate increase due to the exchange rate fluctuation, which is not a final solution for many.

At the same time, we must look for a long-term solution, not with legal tools, as foreign currency lending itself also could not penetrate due to the unfairness of the applied legal solutions. The solution can primarily be found with a complex interference of various tools, and certainly only in the long-term. An authentic and predictable monetary policy with the right tools is essential, the same as an authentic, predictable and thrifty fiscal policy aligned with it. Further, it is important to improve domestic monetary markets and to promote long-term domestic savings.

It should be appreciated that, partially, those positive regulators (legislative right of MNB) and mechanisms which were missing between 2001 and 2011 and could have guaranteed the safe operation of foreign currency loans (and in general the long-term loans) within specified boundaries have appeared and been constructed (KHR, Fair Banking Act and debt brake regulation, mortgage-financing-compliance index serving as a long-term retail credit resource, long-term interest swaps and mortgage debenture purchasing program).

It is extremely important to establish an education system, which efficiently increases the consumers' financial culture level, and is able to provide the education of at least the simplest financial correlations at a basic skill level.

These tools, however, are only capable of preventing similar problems by correcting the experienced imperfections of the market system. They do not provide a solution for managing the problem of debtors in distress. To solve their problems, a proper government social safety net should be created, e.g. launching and subsidizing the previously mentioned social flat building.

7. 5. Summary of lessons learned after 2008

1. Market mechanisms are able to manage the problems derived from the imperfection of the market system within specified boundaries. Legislative intervention is only required beyond these boundaries.
2. It was also proven in this situation that self-regulation and harmonized legislation can regulate social phenomena in the most effective way. A regulation not utilizing

the professional knowledge and experience of market stakeholders does not achieve its objective, usually has detrimental side effects and is wasteful.

3. Preventing similar situations is primarily possible with very carefully harmonized fiscal and monetary economic tools, where the development of retail financial culture plays a priority role.
4. The supporting of debtors in distress is the responsibility of the Government by building a social safety net.

8. (In lieu of an) Epilogue

Based on the above, it can be quite unambiguously established that in the emergence, penetration and management of consequences of foreign currency lending, all participants (government-lender-consumer) played a role and overall did not play their roles well.

However, this study did not investigate the question of responsibility, but merely exposed the reasons for the foreign currency loan phenomena and sought to avoid, or more precisely prevent, similar occurrences. I reached the end of the study with rather mixed emotions, as I see those positive and proactive changes which are able to manage and prevent the occurrence of similar situations. At the same time, based on what happened, I am not sure if we have enough strength and commitment to handle the remaining the consequences. Currently, however, it seems we did not learn a lot from the crisis: on one hand, debt relief was not a solution for numerous debtors, and on the other hand, the situation has not yet been settled, so the subsequent criminalization of a social problem continues.

Dr. Szilvia Kuti
Deputy Notary Public

THE CONSEQUENCES OF THE DRAMATIC SPREAD OF TRANSACTIONS CONNECTED TO FOREIGN CURRENCY LENDING IN THE DAILY LIFE OF NOTARIES AND THE 'REPARATION'[1]

1 Manuscript closed on: 10 October 2018

Initial thoughts

Foreign currency loan. A single expression, a single seemingly harmless concept. I would be curious as to whether there is a Hungarian citizen, between the ages of 28 and 82, who does not have a story related to foreign currency loans. Or, one that he has heard of or experienced. I think not. I also think this concept might be something like a serious disease. One in which many people are affected. Some fight the disease themselves, others know someone who is fighting. There are some who were defeated by the disease, and surely there are others who tell stories of their miraculous recovery.

I admit that the first few lines above constitute an unusual start, moreover: many might think it is pretentious for a study, which should aim at presenting the experiences of a profession related to foreign currency lending. However, it is important to stipulate: this study deliberately has a personal intonation and certainly does not reflect the views of all public notaries regarding foreign currency lending. At the same time, it strives to comprehensively present the kind of role individual public notaries played as law enforcement authorities in the foreign currency lending process, and mentions the kind of impact this engagement had on the daily practice of the profession. The justification of the subjective, possibly not biased, view is on one hand that the author selected the public notary profession and became deputy public notary during the period when foreign currency lending was not yet widely popular, although with time the scope of tasks related to it has gradually become part of her professional life. It would be inappropriate to phrase it generally, since there is no professional public opinion poll among public notaries that could be used to draw lessons and conclusions on the basis of statistical data gained from the responses, and to make more general statements concerning the experiences of public notaries in connection with foreign currency lending.

The story of foreign currency lending in Hungary[2] started at the end of the 1990s, early 2000s, when, as the alternative for subsidized HUF credits, credits denominated in foreign currency by consumers – primarily EUR, CHF and JPY to a minor extent – started to spread in mass numbers. Commercial banks most often provided a loan with the condition that the clients made a directly executable, unilateral declaration of liability based on the loan agreements prepared in private documents in front of a public notary to repay the loan. It also often happened that the public notary included the loan agreement and its insurance contract into the public document. According to my experiences, the accelerated

[2] The loan agreement and credit agreement are not synonyms according to civil law. Act V of 2013 on the Civil Code (hereinafter: Cc.) according to §6:382 (1): *"Based on the credit agreement the lender shall hold the credit amount at disposal, and up to the credit amount held at disposal shall sign the loan agreement, warranty or guarantee agreement, and other contracts regarding the completion of other credit transactions, and the debtor shall pay a fee."* Cc. and according to §6:383 : *"Based on the loan agreement the lender shall pay a defined amount of money, and the debtor shall pay the amount back to the lender, along with an interest rate on a later date defined by the contract."* Despite the above, this study uses the two concepts as synonyms similar to common public usage by fundamentally understanding the retail loan agreements denominated in foreign currency under the concepts of foreign currency credit and foreign currency loan.

demand for preparing the documents put a substantial burden on the public notary offices – certainly the public notary office in Budapest, which was my workplace at the time –, since foreign currency transactions were created by the thousands country-wide. The period of contracting already demanded speed, precision and a somewhat contradicting skill to the latter: flexibility from the public notaries.

In this period however, the "foreign exchange credit" as a concept was not an alternative to an expletive by any means: it rather meant the opportunity for a widely usable, favourable credit for those who applied for a loan denominated in foreign currency. A loan denominated in foreign currency could have seemed more beneficial for the average consumer than a loan denominated in HUF, because the instalment rates of the former started from a lower level than those of the latter. Therefore, in the beginning of the instalment period, the instalment rate of the debtor to be paid to the lenders was less, and it was notable from the contracts the public notaries were presented.

I think it is important to include in Chapter II of the study the general experience of public notaries in document preparation, which has not undergone substantive changes since the heyday of foreign currency lending. The topic is of paramount importance, as the period of document editing in connection with foreign currency loan transactions was a period with a great deal of work, albeit without conflict, still the public documents prepared at this time were those were scrutinized a mere decade later in various forums.

In the initial phase of retail foreign currency lending, it often happened that clients converted their more reliable, but more expensive, subsidized HUF loans to the low interest-bearing, but riskier, loans denominated in foreign currency due to the exchange rate fluctuations, and asked for the public notary's support regarding these transactions. The contracts soon had to be amended due to various general reasons – e.g. collateral swap, succession – , the number of which amendments increased during and after the recession of 2007 and 2008, furthermore, the reason for the modifications was more and more the rescheduling of loan repayments. When putting the amendments of contracts and previously prepared unilateral declarations of liability into documents – in case they were asked – the public notaries also collaborated.

The governmental aspirations to manage the foreign currency lending crisis, such as the exchange rate cap, early repayment and the conversion into Forints performed in 2015, were also measures influencing the activities of public notaries. Also impacting the work of public notaries was that very many debtors "were stuck in their credit", as non-performing loan agreements resulted in cancellation by the banks, and following the cancellations the public notary documentations were generally enforced. The publicising of cancellations in public documents, and – from 1 June 2010 – the enforcement clause added to the documents also took place with the cooperation of public notaries. I will describe the legal problems that arose due to this in Chapter III and IV.

Although most comprehensively we can talk about foreign currency transactions in regards to the preparation of transaction documents, attestations based on a protocol and the ordering of enforcement by a public notary, it is also not a rare case nowadays that the debtor of the foreign currency loan passes away without paying the debt, which then encumbers the heir. Since the execution of succession proceedings belongs to the competence of public notaries, therefore – among other things – the public notaries are also responsible for managing succession cases often containing substantial liabilities. Chapter VI elaborates on the fate of debt arising in succession proceedings.

With the above review, it is notable that, on one hand, the public notaries unintentionally became one of the key players of foreign currency lending, and on the other hand answering the widespread and quite complex questions regarding loan transactions denominated in foreign currency is still one of the regular tasks of public notaries. Consequently, this study also tries to investigate, how, with what kind of internal measures and unique educational experience did and do people practising in the public notary profession try to meet the constantly changing market and legislative demands in the given economic, social and legal environment by the increasing impatience of clients and their dissatisfaction expressed in different ways. Therefore based on personal experiences, the study primarily analyses how the public notary became the "enemy" in the eye of "clients with foreign currency loans", one of the obvious reasons of which was the lack of financial information by clients which could not be compensated with legal information provided to them by public notaries.

1. The emergence of foreign currency lending in Central Eastern Europe and its regulation in Hungary – historical outlook by describing the relevant legal sources and measures from the aspect of public notary proceedings

Act XCIII of 2001 on the elimination of foreign currency restrictions and the amendment of certain related acts created by the Parliament as a consequence of establishing market economy by completing the convertibility of forints and in preparation for the EU accession. This Act which came into effect in two phases in 2002, made foreign currency lending widely available to the public.[3]

Although this legal provision did not specify the concept of foreign currency loans, it is worth noting that a foreign currency loan means a loan in which the disbursed currency of debt is different from forints. These include loans denominated in foreign currency, provided that the loan registered in foreign currency is disbursed by the lender in HUF and the debtor shall also pay it back to the lender in HUF. Therefore, it is important to distinguish the foreign currency transactions and the transactions connected to loans

3 According to Act XCIII of 2001, §1 (3): *"Unless law or a government decree do not dispose of differently, a) the legal transactions and activities of national citizens at home or abroad, b) foreign citizens in Hungary with foreign currency, foreign exchange or national currency, as well as claims regarding national currency may be freely performed."*

denominated in foreign currency, as the latter penetrated a wide range of consumers so that this credit construction was not initially followed by any legislative explanations.[4]

We can establish that Hungary belongs to the newly joined EU member states, in which foreign currency lending spread during the credit extension and became a substantial factor from a macroeconomic aspect as well. Primarily, Hungary and Romania are those new member states where the ratio of foreign currency credits within the retail credit volume exceeded 50 % in 2012. In other countries – such as Estonia, Latvia and Lithuania – foreign currency lending already played a considerable role earlier, therefore credit outsourcing, which accelerated from the mid 2000s was performed by a high foreign currency credit ratio. In addition, there are some countries, like the Czech Republic, where there was no foreign lending, also in Slovakia and Slovenia there was no substantial retail foreign currency lending before the introduction of the EUR.[5]

According to analysers, foreign currency lending may have various economic reasons, although – as I have mentioned in the introduction as well –, their penetration is mostly explained by the difference between the interest rates of foreign currency credits and credits denominated in national currency. More precisely, because in the moment of making a decision regarding credit borrowing the instalment rates of credits in HUF were higher than those of the foreign exchange credits, and many people chose the seemingly more beneficial foreign exchange credits. The economists, of course, did not stick with this "superficial" explanation,[6] however this statement might hold its ground in the framework of this study. Based on my personal experience, if I asked the clients entering the public notary office, almost without

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4 Point III.1 of the Curia's 6/2013 PJE uniformity decision pointed out: *"Upon the penetration of loan agreements denominated in foreign exchange no legal provision defined the concept of foreign exchange denominated loans, at the same time in Government Decree 41/1997 on the calculation and publication of the deposit interest rate, the yield of securities and the Annual Percentage Rate of Charge (APR) (5. III.) (THM 1. Decree) §11/B. and § 13. – without specifying the concept – the rules concerning the legal instrument in connection with the calculation of APR were included. According to Government Decree 83/2010 on the definition, calculation and publication of the Annual Percentage Rate of Charge, effective on 11 June 2010 (25. III.) (THM 2. Decree) §2 (1) a foreign currency credit is a credit, disbursed and paid in other currency than Forints, whereas the credit denominated in foreign currency is a credit registered in foreign currency, but disbursed or paid in Forints. According to Act CXII of 1996 on credit institutions and financial enterprises (hereinafter referred to as: Credit Act) XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in distress due to taking housing loans established with §1, effective from 27 September 2010, section 200/A, the credit, loan or financial leasing contract is denominated in foreign currency, if it was registered in foreign currency, or was disbursed in foreign currency and paid in Forints. According to Act LXXV of 2011 on fixing the exchange rate used for the calculation of the instalments of foreign currency loans and the forced sale of residential properties § 1 section (1) in the concerned act and legal provision issued based on its authorization, a foreign currency loan is an outstanding debt based on a loan agreement erected between a natural person, as debtor, or co-debtor and the financial institution, where the registered currency of the loan is EUR CHF or JPY, and the credit debtor pays his payment obligation in HUF. Hence we can establish that the legal provisions applied quite inconsequent denominations for naming the construction, and certain legal provisions defined the loan denominated in foreign currency partially differently."*

5 András HUDECZ: *Parallel stories*. The establishment and management of retail foreign exchange credit lending in Poland, Romania and Hungary, Közgazdasági Szemle, April 2012, 352.

6 *"Although numerous empiric inspections exposed that interest rate difference has an important explanatory power in the penetration of foreign currency lending, to explain foreign currency lending purely by this would be rather superficial."* See: HUDECZ: i.m. 354.

exception they explained their decision favouring the loans denominated in foreign currency. It is also a fact that the housing subsidy system introduced by Government Decree 12/2001 (31. I.) tightened[7] by Government Decree 221/2003. (12. XII.) introducing a 6-percentage point interest rate increase in ten months also negatively influenced the future of HUF credits.[8]

In Hungary, foreign currency lending flourished between 2004 and 2008, and from 2004 to 2005, following the housing credits denominated in foreign currency, home equity credits denominated in foreign currency also appeared. Public notaries tried to keep up with market demands with intense work, infrastructure extension in some places, and hiring manpower capable of preparing documents in order to seamlessly prepare directly enforceable public notary documentation.

The volume of foreign exchange credits increased between 2006 and 2008 to the greatest extent, which was also promoted by sales via agents, and which enabled clients with lower creditworthiness than before to also obtain credit.[9] This could not be completely filtered by the thorough work characterizing the document preparing practice of public notaries either, although the activities of public notaries had never experienced this kind of random filtering function. Please see more information on this in section II.

Several resources support my personal experience that compared to the entire foreign exchange credit volume, a substantial part of indebtedness was triggered by borrowing credits denominated in Swiss francs.[10] And, since the exchange rate of Swiss francs did not change significantly compared to forints between 2002 and September 2008 – at least it did not deteriorate in the long-term[11] –, credit borrowing became an everyday phenomena, like grocery shopping.

7 The Government published its Decree 221/2003 (12. XII.) amending Government Decree 12/2001 on state housing subsidies (31. I.) on 12 December 2003. The amendment of the Government Decree probably most perceived by the clients was that in case of a mortgage debenture-interest rate subsidy the amount of borrowable credit for buying a used flat, extension or modernization dropped from the previous HUF 15 million to HUF 5 million. Additionally, if the loan applicant utilized interest rate subsidy after the loan has been financed by mortgage debenture, the supplementary interest rate subsidy could no longer be applied for that transaction, i.e. the legal provision excluded the disbursal of previous double interest rate subsidized constructions for the future.

8 On 17 January 2003, the base interest rate was 6.5 %, then ten months later, on 28 November 2003, it was 12.5 % (Source: http://www.mnb.hu/Jegybanki_alapkamat_alakulasa)

9 HUDECZ: i.m. 383.

10 *The base foreign currency of the penetration of foreign currency lending in Hungary was the Swiss franc. The foreign exchange credit agreements were signed in the legal payment currency of the Alpine country, which fought no war for centuries, and owes its wealth and welfare fundamentally to its banks. The Hungarian population having an incomplete financial culture saw safety in the Swiss franc, therefore due to the lack of informative activity of banks and the greed for credit by the population led to the mass-spreading of credit agreements.*" See: Csaba LENTNER: *The methodological scheme of the emergence and consolidation of retail foreign currency lending.* Pénzügyi Szemle, 2015. 3rd issue, 310.

11 Based on the statistical data published on MNB's website the central rates of CHF were the following compared to the HUF: In 2002, HUF/CHF 162.37; in 2003, HUF/CHF 168.30; in 2004, HUF/CHF 159.34; in 2005, HUF/CHF 162.33; in 2006, HUF/CHF 156.99; in 2007, HUF/CHF 152.42. Following the outbreak of the crisis, at the end of 2008, the central rate was HUF/CHF 177.78. (Source: https://www.mnb.hu/statisztika/statisztikai-adatok-informaciok/adatok-idosorok/vii-arfolyam)

Nevertheless, there was no substantive legislation or regulation regarding or influencing foreign currency lending during this period. *"The most resolute measure was the joint recommendation in February 2008, in which MNB and the Hungarian Financial Supervisory Authority drew the attention of banks to the elevated risk of JPY credits, and warned them to proceed with caution when disbursing these credits. The recommendation also included, that the banks should present how a 20% exchange rate shift and a 1-percentage point instalment rate change affect the instalment rate. Although this recommendation was successful of its kind, as the banks retained their JPY lending by the middle of 2008, it did not have a measurable impact on foreign currency lending in general."*- wrote *András Hudecz.*[12]

The financial analysts link the outbreak of the worldwide economic recession and the crisis due to foreign currency lending in Hungary to the events that took place in the United States in September 2008. Namely, a company founded in 1850, Lehmann Brothers – that was registered as one of the largest American investment banks and, at the same time, the world's leading broker company – declared bankruptcy.[13] As a consequence of the international financial crisis, it was primarily the depreciation of HUF compared to CHF and EUR that raised the instalment rates of market stakeholders indebted in foreign currency in Hungary. This had a shocking effect on Hungarian public opinion and the individuals concerned. It is revealing that on this gloomy Monday, from a financial aspect, the euro was 240.92 forints and the Swiss franc was 151.65 forints at a central rate, while a month later, on 15 October 2018, the central rate of the euro was 266.09 forints, and the Swiss franc was 171.81 forints.[14]

Following the outbreak of the crisis, the regulation of foreign currency lending suddenly became acutely urgent and based on the initiative of MNB the Government announced Government Decree 361/2009. (30. XII.). This Government Decree regulated retail lending in two steps: From 1 March 2010, in case of household (retail) mortgage credits and vehicle credits, the loan-to-value ratio was maximized defined in foreign currency.[15] From 11 June 2010, the banks had to specify so-called lending limits.[16]

Compared to the above, it was already a measure by the new Government to prohibit the registration of a mortgage on a property in the land registration office with an effective date of 13 August 2010 if the claim serving as basis of the registration is from a loan denominated in foreign currency provided to a natural person. This measure – which contradicts the EU provisions concerning free capital flow and later became the victim of deregulation – basically eliminated mortgage lending denominated in foreign currency in Hungary.[17] However, there are some analysts, who draw attention to the fact that the decline of foreign currency lending already commenced before the creation of legal provisions, consequently the fact that foreign currency lending disappeared in Hungary is not completely the consequence of these two provisions.[18]

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12 HUDECZ: i.m. 386.

13 Source: https://hu.wikipedia.org/wiki/Lehman_Brothers

14 Source: https://www.mnb.hu/arfolyam-lekerdezes

15 The loan-to-value ratio in case of HUF credits is 80 %, EUR credits 60 %, and other foreign exchange credits 45 %.

16 HUDECZ: i.m. 387.

17 See Act XC of 2010, Chapter VI on the establishment and amendment of certain economic and financial laws, and in its deregulating act, the contents of Act LXXVI of 2012 on the technical deregulation of certain acts and legal provisions required to eliminate the over-regulation of the system.

18 HUDECZ: i.m. 387.

In addition to the measures restricting foreign currency lending, several new acts and other legal provisions also strived to reduce the burdens of debtors with foreign currency loans. One of the legal provisions was regarding the prolongation of the eviction moratorium. This rule, applied to the winter period, was prolonged by the Government until 15 April 2010.

Act XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in a difficult situation due to taking housing loans was approved in autumn 2010, which contains a package supporting debtors with foreign currency loans. According to the Act, it is mandatory for the banks to apply the central rate defined by them or MNB, and the Act also attempted to restrict the unilateral amendment of interest rates. It included the relevant rule – regarding the ordering of enforcement by public notaries – that the bank shall not charge default interest from the 90th day following the termination of the credit agreement, and in case of early or final repayment of credits, the maximum fee can be one per cent of the paid amount. Further, it was a substantial regulation that in case of mortgage credits for housing purposes the debtor could request the prolongation of the credit duration by maximum five years in writing, which could not be refused by the bank without serious grounds.

The so-called "Home Protection Program" or "Home Protection Action Plan" was introduced in May 2011. It stipulated the agreements between the banks and the government in five points concerning support for debtors with foreign currency loans.

The first item of the program was the so-called "exchange rate cap" regulations implemented by Act LXXV of 2011 on the fixing of the instalment rates of foreign currency loans and the forced sale of residential properties. Based on the Act, the debtor could apply to pay their foreign currency credits by 31 December 2014 at a fixed exchange rate.[19] For the difference between the actual and the fixed exchange rate, the banks disbursed HUF credit, the so-called omnibus account credit. In connection with this, the debtor had no payment obligation during the period of the fixed exchange rate. Its interest rate equalled the short-term mid-bank interest rates. The payment of omnibus account credit had to be started from 1 January 2015, along with the foreign exchange credit payment that was reset to market rate in the meantime.[20] The public notaries acquired a new task at this point: based on the credit amount agreements regarding the omnibus account credit, they prepared the directly enforceable declarations of liability in the documents by debtors. The public notary fee and the expenses for their issuance was borne by the lender.

The option of the omnibus account credit was beneficial for those who had temporary payment difficulties, and in general it would have been the right solution, if the forints had appreciated during the period of fixed exchange rates. In my experience, few clients utilized this opportunity, and those who did choose this option found that they could only "breathe" with the omnibus account construction.[21]

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[19] The CHF credit was fixed at HUF 180, the EUR credit at HUF 250, and the JPY credit at HUF 2.5 exchange rate.

[20] Based on the agreement between the Government and the Banking Alliance on 15 December the debtors, who were able to pay still had an opportunity to enter the exchange rate cap for another year, until the end of 2012. According to the agreement, the fixed exchange rate was guaranteed for 60 months, but latest by 30 June 2017.

[21] With Act LXVIII of 2013 entering into force on 1 June 2013 on the amendment of Act LXXV of 2011 – therefore it was applicable for the transactions that were signed after this date – the closing deadline of 31 May 2013 specified for the submission of applications for an omnibus account was later dismissed. Additionally, the closing date of 30 June 2017 regarding the application of the fixed exchange rate was also abolished. The amendment act also disposed of enabling the exchange rate cap for borrowing a foreign currency loan over HUF 20 million in case of at least three children..

The action plan included the option of limited auctioning of properties, since from 2 July 2011 the eviction and auction moratorium were cancelled, and banks could start the auctioning of properties based on quotas. Lending denominated in foreign currency was restarted and its system of conditions was established when they announced the release of the mortgage credit lending prohibition. Furthermore, the program contained the establishment of the National Asset Management.[22]

The Government announced its "country protection package" in September 2011. The point concerning people with foreign currency credit was that the costs incurred in HUF in case of foreign currency credits should only be specified in HUF, and it enabled final repayment at a fixed exchange rate.[23] The majority of financial experts criticised the execution of final repayment by stating that it does not provide an opportunity for the people in real need to get rid of their foreign currency credits.

Afterwards, the Government and the Banking Alliance signed an agreement on 15 December 2011, three points of which concerned retail foreign currency lending. On one hand, the final repayment conditions were tightened. On the other hand, the previous exchange rate cap was extended by the Government assuming the payment of the interest from the debtor over the specified exchange rate, while the capital portion over the specified exchange rate converted into forints earned interest on a separate omnibus account until the expiration of the fixed exchange rate, then the debtor has to pay it. The third regulation was regarding the conversion of foreign currency credits of clients in default status over 90 days on 30 September 2011 into forints between 15 March 2012 and 15 April 2012, a further 25% of the debt is nulled and the Government provides a 5-year, yearly depreciating interest rate subsidy for the credit that was converted into forints. The pre-condition of this was that the reason for the default status should be a permanent deterioration of the debtor's solvency, also that the market value of the property that serves as collateral for the property is maximum HUF 20 million on the contracting date.

For the sake of the enforcement of requirements derived from the civil uniformity Decision 2/2014 of the Curia, as well as the preparation of additional measures, the Parliament prepared the Act which is simply referred to in everyday speech as the "first foreign currency credit act". This was Act XXXVIII of 2014 on the resolution of questions relating to the uniformity decision of the Curia regarding consumer loan agreements of financial institutions. It was followed by the so-called Settlement Act on the settlement of retail overpayments related to unfair contractual terms,[24] and also Act LXXVII of 2014 on settling issues related to the conversion of the currency of certain consumer loan agreements and to the rules governing interest rates (Forint Conversion Act). Finally, Act CLXII of 2009 was created on consumer credit and Act LXXVIII of 2014 on the amendment of certain related acts (the so-called Fair Banking Act).

22 *"… the basic idea is that the government purchases the properties of insolvent debtors from the banks, who then in turn rent it back from NAM. The act on the above was passed by the Parliament on 5 December 2011. NAM commenced its operations on 1 January 2012. According to the original plan, it would have purchased 5,000 properties by 31 December 2014, but (…) this number was increased by the Government to 25,000. (…) Until the submission of the manuscript NAM has not purchased a single property yet."* See: HUDECZ: i.m. 403–404.

23 HUDECZ: i.m. 404.

24 Act XL of 2014 of the Curia on the Rules of the Settlement and Certain Other Issues Set out in Act XXXVIII of 2014 on the Resolution of Questions Relating to the Uniformity Decision of the Curia Regarding Consumer Loan Agreements of Financial Institutions (hereinafter referred to as: Settlement Act).

The regulations of Act LXXVII of 2014 on the amendment of retail loan agreements by the power of law came into effect on 1 February 2015. The financial institutions had to settle the loan agreements denominated in foreign currency and the foreign currency loan agreements, as well as to convert cancelled (but still registered as default claim) debts into forints on this date. The provisions of the Act regulated the rules of settlement in a remarkably complex way, which required extraordinary attention, learning and a huge amount of work from the public notaries, concerning the interpretation of which the associates of the legal Office of the Hungarian National Notaries Chamber (hereinafter referred to as: HNNC) provided support. They created the tables in Annex 1 and 2 supporting the work of public notaries, which meant extraordinary help in keeping deadlines, and bringing proper procedural actions, measures and decisions.

In regards to the procedures of public notaries, the greatest importance was held by the provision contained in Act LXXVII of 2014, § 4 (2) c). Based on the above, from 1 February 2015[25] the adding of an enforcement clause to the public notary documentation regarding the borrowing of credit denominated in foreign currency was only possible to be requested for retail loan agreements amended by the power of law, and § 15 (1) for debt converted into forints, i.e. only for forints.

The other important regulation, from a public notary perspective, was that when the applicant of the enforcement reported the sending of the settlement to the debtor on such date, by which the enforcement document has not been sent to the executor yet, the applicant of the enforcement had to send the announcement to the court ordering enforcement, as well as the public notary in case of enforcement proceedings initiated based on a document prepared by a public notary.[26]

By creating the last three important legal provisions, i.e. the "first foreign currency credit act", then the Settlement Act, and the Fair Banking Act – the latter made lending more reliable for the future – concerning legislation from 1 February 2015, a very tough period of domestic foreign currency lending has more or less ended. Simultaneously, foreign currency credit contract transactions – at least concerning retail lending – also disappeared from the public notary offices.

2. The practice of embedding contracts and unilateral declarations of liability into public notary documentation – during the heyday of foreign currency lending and today

2. 1. Unconventional introduction

"Mr. Róna, who graduated from Oxford University with international credits believes, that besides the credit institutions, intermediaries and financial supervision, indeed the public notaries are also fully responsible for the foreign exchange credit problem. 'The public notaries generally authenticated the credit agreements written by the banks by exactly knowing that

[25] The provision shall be applied for applications to order the submitted enforcement on or after 01 February 2015.

[26] Settlement Act § 41 sections (2), (3) and (9)

the material was incorrect, moreover, even they were unable to interpret them. Nevertheless, they qualified the contracts as notarial documents, consequently deprived the borrowers of credits from the opportunity of legal remedy.' – reckons Róna, who previously led a British bank. With this, enforcement proceedings can be initiated without a binding court decision – and the debtors can soon find themselves in deep poverty and homeless."[27]

Seeming to break with the chronology, I open this chapter with a statement attributed to Péter Róna, made in 2013 and available on the internet. So, this is from the period when foreign currency lending had finished, however the negative economic effects of previously made transactions appeared, and when the first court decisions were made and the responsible persons of foreign currency lending were sought after in all forums. For the sake of factuality, I must state that I do not know whether this statement was precisely made in this way, or if it is really by Péter Róna. Still, I start with this statement, because I think this offers a proper picture of the kind of public atmosphere the public notaries faced after several years of peaceful, but busy, period, which was characterised by "contract dumping". According to my view, the above statement has great importance although – as I will mention later – it lacks all professionalism and contains factual mistakes, it is capable of undermining the prestige of a profession and "identifies" the work requiring thorough professional knowledge from its members "as null", or worse case, expressly harmful.

Considering the above, I believe it is important to demonstrate how long the competence and task of a public notary generally extends during the editing procedure of documents: what is professionally required from a person assigned with authenticity and practising public authority, and what is certainly not his or her task.

2. 2. The rules of public notaries' editing procedure of documents – in light of certain invalidity excuses mentioned in foreign currency credit lawsuits

The rules of the activity and the procedures of public notaries among other acts are contained in Act XLI of 1991 on public notaries (hereinafter referred to as: Public Notary Act). Accordingly, the public notaries provide impartial legal service in their competence specified by legal provision, by performing actions of jurisdictional authority as part of the government's judicial activity, in order to prevent legal disputes. Connected to the above – "inter alia" – they issue notarial documents on legal transactions and facts of legal importance, as well as support the parties by providing information regarding proceedings assigned to their scope of competence and in practising their rights and fulfilling their obligations.[28] One of the most important tasks of public notaries – which was also performed in connection with the foreign currency transactions – is the embedding of different contracts and legal declarations into notarial documents.

27 Source: https://hitelkarosultak.blog.hu/2013/10/04/a_vilaghiru_kozgazdasz_kitart_hibas_termek_es_csalas_a_devizahitel

28 Public Notary Act § 1.

Regarding notarial documents, we distinguish between transaction documents and notarial attestation documents (public notary certificates), out of which the latter have priority roles in cancelled contracts, and which I will mention in Chapter III of the study.

2. 2. 1. Unfair contractual conditions

The public notary shall fundamentally cooperate in legal transactions, but shall also reject collaboration, *"if it cannot be aligned with his obligations, especially if his cooperation is requested for such legal transaction, which is against law, or aims at bypassing the law, and which has a prohibited or unfair objective"*.[29] Should the public notary notice a concerning condition during his proceedings, but has no reason for rejecting cooperation, he shall draw the attention of the party by indicating the condition of concern in the document. If the party objects to the inclusion of this warning in the document, the public notary also rejects cooperation in the transaction.[30]

It is worth taking some time at this point, since it was an often-mentioned argument in foreign currency credit trials that the contracts embedded into a notarial document are invalid, because they contain unfair contractual conditions.

In case of loan agreements denominated in foreign currency, the debt was established in foreign currency, and the debtor's payment obligation in forints depended on the exchange rate fluctuation of the forint and the concerned foreign exchange relative to each other. Point III.1 of the Curia's uniformity Decision 6/2013 stipulates that with these contracts the exchange rate fluctuation is a risk factor influencing the amount of instalment rates, the bearing of which by the debtor was offset by a more favourable transaction interest and lower instalment rate compared to the HUF loans.

"Since Acts DH1 and DH2 entered into force debtors most often declare the unfairness of the contractual term placing the exchange rate risk on the debtor, with reference to the Curia's civil law uniformity decision 2/2014 (…)".[31]

Since the unfairness of a given contractual condition should be examined in regards to the contracting date, unfairness can be established if it can already be shown at contracting that it is unilaterally and unjustifiably disadvantageous for the contracting party appealing against it. During the period however when the foreign currency loan agreements were created, the future development of the exchange rate fluctuation of HUF compared to the CHF or other foreign currencies, and the direction and extent of the potential fluctuation was not known for the debtors, financial institutions and, of course, public notaries. Based on the above, the argument does not hold that the public notaries collaborated, e.g. in the preparation of contracts contradicting good practice due to the shifting of the exchange rate risk on the debtor. Even if subsequently – after involving many negotiation days and numerous experts – the court rates a contractual condition unfair we still cannot state in general that public notaries collaborated in preparing contracts, regarding which *"they exactly knew that the material was incorrect."*

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[29] Public Notary Act § 3. Section (1)

[30] Public Notary Act 3. Section (2)

[31] Katalin SZEGHŐ: *"Foreign exchange lawsuits" with the eye of a judge.* Gazdaság és Jog, 12/2015. 7. (Under DH1 the author means Act XXXVIII of 2014, and under DH2 means Act XL of 2014.)

2. 2. 2. The educational and information obligation of public notaries during document editing

A question tightly related to the previous topic is how far the information obligation of a public notary extends in the document editing procedure with transactions, the details of which the parties did not agree on in front of a public notary. Namely, it is undoubted that the foreign currency credit agreements were not worded by the public notaries, but banking jurists, and these contracts were the drafts for directly enforceable notarial documents prepared based on them. This is why the otherwise completely erroneous idea spread, according to which: "*the public notaries (…) authenticated the credit agreements written by banks…*". This wording is incorrect, because a public notary does not authenticate the contract based on a signed private document, or draft provided to him by the client, but embeds it into a notarial document, and only does so if it can be the subject of a document that can be directly enforced.[32]

Based on the above, therefore, in regards to private documents already prepared and provided at the public notary's disposal, the public notary investigates whether it includes enforcement tools, i.e. is there a place for direct enforcement based on the notarial document prepared based accordingly. Regarding the above, § 23/C of Act LIII of 1994 on court execution (hereinafter referred to as: ExAct.) is authoritative.

When preparing the notarial document, the notary public is also responsible for confirming the party's transaction abilities and entitlement, as well as his real intention. During the document editing procedure, therefore, the public notary practically asks such questions from the clients, by which it becomes clear whether they have transaction signing ability and are accountable, eligible for participating in the transaction or not, and also if they are aware of the essence of the legal transaction, which in case of foreign currency credit transactions was already concluded previously in a private document. Additionally, the public notary shall also notify the client about the rights and obligations the client has based on the notarial document, and the legal consequences of signing the document. Based on my experience, clients initially were not clear on one of the essential legal consequences of the notarial document containing commitment, that it could be directly executed, and by far not clear on what this legal consequence actually meant.

Therefore, the public notary provides information for clients about this and similar legal topics related to the concerned document, based on which they could consider whether to sign the document or not. The public notary "*may examine contradiction to law, or an intention to bypass that and the existence of other nullity reasons, as well as some provision leading to legal dispute, if they are unambiguous from the document, or the circumstances following the reading out of the document.*"[33]

I have to say that based on the information I provided, not a single client decided to make a directly executable declaration contained in a notarial document regarding the signed loan agreement in a private document, and to waive the borrowing of the loan.

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32 The classic authentication-related procedure of public notaries is regulated by § 137 of the Public Notary Act, which is not identical with either the issuance of transaction documents, nor of attestation certificates.

33 Lőrinc ASBÓTH-HERMÁNYI: T*he informative and educational obligation of public notaries.* Közjegyzők Közlönye (Public Notary Journal), Special edition 2013, 14.

In addition to the above, it is important to note that the informative obligation of public notaries never include such questions, which require specific competent knowledge in the transaction. Namely, it never includes answering such financial-economic types of questions, such as, for example, the financial risk the signing of the foreign currency loan agreement has for the debtor.[34]

2. 2. 3. The reading out of the document

Based on the Public Notary Act, public notaries shall prepare the documents by observing formalities specified by law. When we mention observing formalities, one of the most important requisites of formality is the reading out of the notarial document in front of the parties participating in the legal transaction, the waiving of which is only allowed by law in exceptional cases.[35]

In connection with foreign currency credit transactions, another argument in lawsuits by debtors is that the public notary did not read out the document, consequently it is formally invalid.[36]

As I have already mentioned in the introduction, this study is a personal work, and when I elaborate on the topic of reading out, I would like to emphasize it. It is important for me to

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34 ASBÓTH-HERMÁNYI: i.m. 14.

35 According to the Public Notary Act § 120 section (2): "*The read out of the notarial document prepared based on the provided written draft by the parties with the exception of the text of the amendment made to the draft and any supplements, if the legal persons acting with legal representatives declare in front of the public notary in unison that they learned about the document draft, therefore they are requesting the waiving of the reading out of the document. The waiving of the reading out does not concern the fulfilment of other obligations specified in connection with the preparation of the notarial document. The waiving of the reading out is not allowed, if any of the parties is a person listed in §124 points a)–c).*" In addition, according to the regulations which were effective until 31 December 2017, the same rules apply to parties entering into a subsidized credit agreement (mortgage credit agreement) based on a separate provision on state subsidies for housing purposes.

36 In its Decision no. 73.Pf.632.870/2018/4 the Court of Justice of Budapest established based on the expert opinion of a judicial linguistic expert and the statements of witnesses, that concerning a notarial document prepared in 2008 – containing a loan agreement denominated in foreign currency and its insurance contracts – the plaintiff successfully proved that the acting deputy public notary did not read out the 30-page contract package in its entirety. The verdict also included, that the document does not contain the starting and finishing times of the reading out either, even though based on the Public Notary Act §120 section (1) d) it should have been recorded. Beyond the fact that I consider the verdict ungrounded from several aspects, it is especially striking that based on a document that was prepared in 2008, the acting colleague is also accounted for a provision effective from 1 July 2015: the registration of the starting and finishing times of the read out. Such direction of the verdict is concerning, because for example the explanation by the linguistic expert requested in the given case is also considered as belonging to the read out, although the explanations regarding the transaction do not belong to the read out, and its duration is not included in the duration of the read out. Furthermore, the debtor declared in the public document of 2008, that the deputy public notary read out the document in front of him, however, the court assessed it as the successful evidence for not reading out, that the respondent along with the deputy public notary witness could not prove that the read out took place, although it is proven by the notarial document itself. In addition, the court established the necessary read out time completely out-of-touch from practice and real life in 2 hours and 40 minutes, although the read out of a 30-page document could only last this long if a reason arises from the person of the client – e.g. hard of hearing, or has an interpreter –, or in the circumstances, which extends the duration of document editing.

state that the reading out of the document is a warranty rule from the aspect of public notary operations. Personally, I fully understand the aspirations of clients to "get out of" listening to the reading out, and I am aware that the reading out of an often more than 30-page document, which is hard to understand and is full of special legal and economic words – a few parts of which do not concern the given transaction of the client at all – does not seem realistic. Therefore, I created my own practice that, on one hand, I "tailored the duration of the read out to the client", i.e. I adjusted the speed of the read out to the extent to which the client's personal circumstances, habits and competence in his own transaction required detailed explanation. On the other hand, I also made sure to give particular attention to a few important sections – e.g. the method of redemption, the reasons for termination listed in the contract, and the obligations of the client in general. My document editing procedure has not changed in this respect to this day.

The parties may also submit a draft to the public notary for the preparation of documents, which the public notary may include in the notarial document with unchanged content, and in case the contracts entered in a private document are unilaterally or bilaterally confirmed, the contents of the private document become the part of the notarial document word-for-word. In the vast majority, those transactions were presented to public notaries, in which the obligors of loan agreements denominated in foreign currency and their insurance contracts made a unilateral declaration of liability in front of the public notary. Thus, the contracts were not prepared by the public notary, and the legal transaction did not emerge by being embedded into a notarial document, but they were already created in the form of a private document. Accordingly, the clients could have enough time to understand the details of their contracts independently, and based on the information provided by the associates of the credit institutions it was not the reading out of the document that made the essence of the transaction clear to them. If during the document editing the public notary had a suspicion that the client was not aware of the essence of his own transaction, it might qualify as a concerning circumstance, based on which the rejection of cooperation might be grounded. Regarding this however, I never had to decline cooperation in foreign currency transactions.

I believe that by carefully extending the scope of exceptions, the reading out of notarial documents is needed, since the reading out is one of the warranty elements of the proper formality of notarial documents. At the same time, the reading out also has practical significance in providing an opportunity for clarifying the still arising questions by the parties before signing it, furthermore, the reading out can help to filter out countless typos and contradictions from the transaction documents.

During the document editing those short, few-page templates still provide support which contain the essence of contracts and specifically the requisites of enforceability. Therefore, in the future, it might be worthwhile to create and apply such summary document templates, based on which execution must not be an obstacle, and the public document remains of reasonable length for the clients as well, further, which – as far as I know – many public notary colleagues are promoting.

Referring back to the already referenced decision of the Budapest Municipal Court[37], finally I have to mention that I am expressly concerned about the judicial practice of trying to investigate, by ordering a juridical expert in the lawsuit, whether the public notary read out the notarial document

[37] Decision no. 73.Pf.632.870/2018/4 of the Budapest Municipal Court.

during the time the client – according to their statements – was in the public notary office. On one hand, I do not think the general investigation concerning how long the reading out of a document takes is justified, because the reading technique and speed of public notary colleagues, as well as the reception ability of clients vary, therefore only after the thorough exploration of the bearing of individual cases can we say that the reading out was waived in the concerned case. On the other hand, it is also important to state that the notarial document has special power of evidence in regards to whether the person listed in the document has made the contractual declaration at the place, in a way and on the date stipulated in the contract. Moreover, the declaring person also proves that by his signature with the exceptions listed in the Public Notary Act.[38] Additionally, the presumption of reality is connected to the notarial document, which means that until the opposite is proven, the notarial document should be considered as one derived from its issuer in its entirety. Counter-evidencing the contents of the notarial document is only applicable if law does not exclude or restrict it. During evidencing, the person, who is arguing the contents shall prove that the notarial document is not authentic, or the facts incorporated in the document do not exist. At the end, referring back to the described legal case, my standpoint is that the debtor as respondent and the public notary witness cannot possibly prove that the document was read out, shall not be assessed as the reading out did not happen, while the doubted notarial document itself proves the fact of the reading out.

3. Document editing dilemma related to the attestation of the termination of contracts and the attestation of other enforceable requisites by a notarial document

In regards to notarial documents, we distinguish between transaction documents and public notary attestation documents (public notary certificates). The attestation documents – inspecting it from the aspect of foreign currency loan transactions – play a prominent role on one hand upon the cancellation of contracts, and on the other hand during the attestation of other dates and conditions by a public document, without which the basic notarial document (i.e. transaction document) could not be directly enforced. The legal consequence of direct enforceability may be attached to the transaction document, if it meets the conditions contained in § 23/C. of the ExAct. Based on the ExAct. § 23/C section (1), a document is enforceable if it includes a unilateral or bilateral commitment regarding the service and consideration, the names of the entitled and the obligor, the subject, quantity (amount) and legal title of obligation, as well as the method and deadline of payment.

It might also happen that when the contracting parties agree on the details of their contract it does not include all enforceability requisites yet, as the fulfilment of obligations undertaken in the contract depends on events or other conditions, which will happen at an unforeseeable future date. Regarding the above, the referenced law says: *"If an obligation depends on the supervention of a condition or date, enforceability also requires that the supervention of the condition or date is certified by a public document."*[39] It is important to mention, that this

[38] According to the Public Notary Act §117 section (3): *"The party and other interested persons sign or initial the notarial document at the end. If he is not able to do so, his signature is substituted by the signature of the public notary."*

[39] ExAct. § 23/C Section (2)

"attestation document" does not need to be a notarial document. In certain cases, the other document may be: a property deed, birth certificate, court decision or even a personal ID that may be suitable for certifying the supervention of the condition or date.

The transaction document, i.e. the document to be equipped with an enforceability clause must by all means include the elements contained in § 23/C section (1). The public notary certificates or other notarial documents only serve the purpose to certify the supervention of a condition or date required for ordering enforcement. However, it is also important to highlight that during the interpretation of the aforementioned law article and the procedure for the ordering of enforcement numerous legal disputes took place concerning the acceptability of usable documents, and consequently, different public notary practices were formed.

Regarding the foreign currency loans contained in notarial documents, the following must be highlighted. The loan agreements contained in regular notarial documents certainly include that the referenced bank provides a certain amount of money under the legal title of the loan to the also referenced debtor, and the debtor shall pay it back with interest, by the specified deadline and by means agreed upon by the parties. In case of a unilateral declaration of liability, the debtor's related unilateral declaration that based on the loan agreement signed with the bank he shall pay the loan with interest back to the bank is contained in the notarial document. In case of a loan borrowed in Hungarian forints and to be paid back in forints in one lump sum, in cash, results in a simple formula. If a loan agreement was embedded in a public document, or based on a loan agreement created in a private document the debtor made a declaration of debt or a unilateral declaration of liability, and the debtor does not perform on the date following the repayment deadline, the proceedings for ordering enforcement regarding the document can be initiated in front of a public notary.

In contrast, a loan transaction denominated in foreign currency is a complex equation. The lender disburses the loan registered in foreign currency in forints, and the debtor shall also pay it back to the lender in forints, but the amount to he repaid greatly depends on the exchange rate fluctuation of the concerned foreign currency compared to the forint, thus it cannot be specified in advance. These transactions are also characterised by the debtor typically paying the loan back to the lender in instalments, therefore the contractual term in most cases says that if the debtor defaults by one single instalment, the entire debt becomes enforceable and the lender may terminate the loan agreement. Therefore, it is obvious that according to the strictest interpretation, even the transaction document prepared in regards to the simplest loan transaction denominated in foreign currency could not include the enforcement requisites contained in § 23/C. section (1) of the ExAct, however, they can be substituted by attestation documents.[40]

[40] According to Act LXXV of 2011 (hereinafter in this sentence referred to as: Act) §1 section (1) related to a loan agreement regarding a foreign currency loan, the public notary document template containing a declaration of debt (unilateral declaration of liability) applied in connection with credit agreements concerning omnibus accounts based on the provisions of the Act and registered at the Lender – by its nature regulated in the Act – contained even less enforceability requisites, since at the time of contract amendments neither the actual amount of the loan disbursed based on the omnibus account credit, nor the payment obligation concerning its repayment (the amount of the instalment rates, or the number and maturity (duration) of instalment rates was possible to be defined.

In regards to the issuance of attestations and their utilization in the proceedings regarding the ordering of enforcement, a law interpretation question most often only arises in two topics in practice: in regards to the embedding of terminations in a notarial document, and the attestation of the amount of liabilities.

3. 1. Law interpretation problems arising in connection with the attestation of terminations

Concerning the requirement of incorporating the termination into a public document, already seemingly contradicting views were formed in legal practice before the scope of competence of public notaries was extended by the proceedings for ordering enforcement.[41] And, since during their proceedings in their new scope of competence the public notaries – adapted to their own procedural order – tried to satisfy the established judicial practice, therefore initially they had to perform thorough research on numerous questions to form correct practice.

It can be mentioned as an example that the Supreme Court in its Decision no. BH 491 of 2002 stood by incorporating the termination into a public document. According to the standpoint in Case Law no. EBH 2008/1786 published in provisions of principle, however the adding of the enforcement clause to the public document, the incorporation of termination into the public document shall not be claimed, and the public document attesting the announcement of the termination is sufficient. Even though the contradiction between the two decisions is only apparent, since the standpoints serving as their bases are different, in Case Law no. EBH 2008/1786 the acting court arrived at the conclusion that for the termination to take effect the notarial document, in which the lender declares that he delivered the termination to the debtors in the given time by presenting the return receipts in front of the public notary and attaching them to the document, is efficient. However, one cannot agree with this standpoint, since as Tamás Ujvári public notary phrases it in one of his publications: *"(…) the reason the declaration of the person applying for enforcement cannot be accepted for ordering enforcement, as then the public documentation attestation specified in § 23/C. section (2)of the ExAct would become mere formality."*[42]

While ordering the enforcement proceedings by public notaries, the following procedure was established in regard to incorporating the terminations into an attestation by protocol: the lender presented the termination that was already sent to the debtor in front of the public notary and asked the public notary to incorporate its text into a public document, and also attest its repeated announcement to the debtor, and the delivery of the document. According to the view of some public notaries, this procedure is identical to the duplicate termination of the contract, which however is not possible. Based on other views, this is not the case here. Although the termination already came into effect by its announcement

[41] From 1 June 2010, the ExAct – inter alia – was amended that the public notary may assign the enforceability clause to the notarial document prepared by him.

[42] Tamás UJVÁRI: *The role of notarial attestations in enforcement proceedings.* In: *Celebratory study for the jubilee of the public notary profession* (edited by: BÁN Tamásné TÓTH Dóra and Gábor ROKOLYA). Közjegyzői Akadémia Kiadó, Budapest, 2017. 381.

in a private document, this legal impact is not attached to the second – or even multiple – announcement by the public notary, but the double or even multiple announcement(s) of the same termination has no obstacles.[43]

A verdict of the Curia – published shortly before concluding this study –[44] may release this contradiction. The verdict says that *"(...) the obligation to incorporate the termination into a public document[45] cannot be derived from a legal provision. (...) the plaintiff correctly implies, that the legal impact of the cancellation of the contract is not attached to the subsequent termination in a notarial document, however, its role is anyway different: the termination incorporated into a public document has no transactional scope, the public notary only attests the fact, that the entitled person announced the contract termination, hence the maturity of the entire claim in front of him. (...)"*

In the topic of termination, it is also worth mentioning that initially there was no uniformly applied practice regarding the form of terminations by the public notaries. There were some declarations, i.e. declarations of termination made in the form of transaction documents, which had to be read out by the public notary. There were also declarations recorded in the form of attestation by protocol, which attestations only have to be read out if the ExAct specifically disposes so.[46] As far as I know, today the documents on terminations are prepared in the unified form of attestation by protocol, regarding which in his application to cancel the enforcement clause the debtor may not refer to the fact that the termination without being read out is not a public document.[47]

It was specifically brought up in regards to foreign currency loan transactions, therefore the provision is listed in §45 section (2) of the Settlement Act, according to which the retail loan agreement could be terminated by the financial institution due to the non-performance of payment obligation of the consumer, with the effective date following the sending of the settlement according to the Settlement Act to the consumer, and its default liabilities towards the consumer could mature in one lump sum with the same date. According to section (3), the termination as per section (2) could become effective on the day following the sending of the settlement, but latest on 31 December 2016, if the legal and contractual conditions constituting the forfeiture

43 UJVÁRI: i.m. 383.

44 Pfv.I.20.386/2018/4.

45 In its verdict the Curia refers to §23/C of the ExAct.

46 Public Notary Act §120 section (1) d) (The legal provision reinforced the previous practice effective from 01 January 2008.)

47 Following the submission of the manuscript, the amendment of the Public Notary Act came into effect on 1 January 2019. According to the amended §142 section (2) of the Public Notary Act, the text of the termination to be delivered by the public notary shall be read out by the public notary in front of the client: *"The public notary incorporates the text of the declaration or notice into a protocol word-for-word, and forwards the document via post to the other party as registered mail, or one with return receipt, also by means specified in the E-administration Act. The public notary reads out the incorporated text of the declaration or notice in a protocol in front of the person making the declaration, and this protocol must be signed by the person making the declaration. The public notary gives a certificate to the party submitting the request about announcing the text of the declaration or notice, in which he indicates the text of the declaration or notice word-for-word, the name and address of the parties, the place and day, month and year of posting, and based on the request of the applicant, the hour as well."*

of right for termination and fulfilment in instalments also existed towards the consumer as the result of the settlement. In regards to such transactions, the public notary could not proceed by the routine, but had to also consider that in addition to the termination the effectiveness of the settlement sent to the consumer had to also be certified in order to fulfil the condition, based on which the scope of commitment has matured, and the payment obligation has expired regarding the repayment of the remaining loan amount in one lump sum.

3. 2. Law interpretation problems arising in connection with the attestation of the amount of liabilities

The credit institutions still often contact the public notaries to record an attestation of facts regarding the amount of debt according to the debtor's declaration of liability on a given date based on the bank's registries. These attestation of facts are mostly prepared by the clients, based on a preliminary consent made in the transaction documents, and the banks usually use it with the public notaries who prepared the basic transaction document, i.e. the document to be enforced in the transaction. Namely, with those public notaries whom they can initiate the adding of an enforcement clause to the document.

I believe that the increased demand for attestation and the preparation of such attestations in an attestation of facts by a public notary regarding the amount of liabilities – most often as part of the declaration on termination – can explained by the fact that the disbursed forint amount to the debtor upon borrowing the loan denominated in foreign currency was in most cases exceeded by the repayment amount by orders of magnitude, and the bank wanted to announce that to the debtor. With this, the information was already sent to the debtor in the termination, and he did not face it for the first time during the enforcement process. It is not disputed that the sight of the enforceable amount in case of foreign currency loan transactions must have had a shocking impact on all debtors, without exception.

The principle is authoritative to all attestations, however, with the above attestations – containing non-verifiable data, amounts and statements for the public notary – it was especially prevailing that in case of attesting the making of a declaration, the entire attesting power of the document only concerns the fact that the declaration was made. Namely, to the fact that the declaring client made his declaration in front of the public notary, at the given place and time and with the contents incorporated in the document. The attestation document however does not prove that these declarations are completely true.[48] This warning may even be contained in the notarial attestations, although it is not a mandatory element of them.

It is also important to emphasize, because it spread in everyday speech, that public notaries are "the notaries of banks", who collaborate in editing documents containing false data. Based on the views of plaintiffs in numerous lawsuits, that the amounts indicated in the attestation documents cannot be real, is exaggerated. It is indisputable, that due to the exchange rate fluctuation, the increased amounts registered as the remaining debt of debtors were much higher than the

[48] Viktória HARSÁGI: *Preventive law protection – the document editing activity of public notaries.* Közjegyzők Közlönye (Public Notary Journal), 3–4/2014, 41. (The author is referring to the punitive uniformity Decision no.1/2004 of the Supreme Court, which in its point III says, that "*it does not qualify as intellectual public document forgery e.g. the false testifying, by which an untrue fact is recorded in the protocol, or provision".)*

amount of loans borrowed by them. However, the representatives of banks made declarations about their extent in front of public notaries in full awareness of their criminal liability.

It follows from the above that the transaction document that can be enforced based on § 23/C section (1) of the ExAct – the foreign currency loan agreement – must reliably contain the debt of the debtor in a quantified amount. Consequently, based on my opinion the above attestation documents could only have an informative nature in enforcement proceedings. As I have already elaborated, the foreign currency loan agreements could not necessarily contain the precise loan amount to be repaid in case of the supervention of specified conditions, i.e. practically, in the event of the debtor's default. The transaction documents however had to contain those principles of settlement, based which the amount to be paid can be calculated. The notarial documents prepared based on the foreign currency loan agreements defined whether the debtor had to pay his debt in forints or in foreign currency, and if the debtor is obligated to repay his loan denominated in foreign currency in forints, then at which exchange rate he had to do so.

At the same time, it is important to note that when ordering enforcement the public notary is not able to examine the amount of the claim, therefore the attestation of the amount of outstanding liabilities has no significance regarding the enforcement proceedings. *"The public notary ordering enforcement is only entitled and obligated to examine whether the amount to be claimed exceeds the amount contained in the enforcement document. There is an opportunity for the examination of rendered payments in the meantime during the enforcement proceedings (ExAct. §41) or in the lawsuit regarding the termination (restriction) of enforcement."*[49] However, initially, the public notaries' practice was not unified in this question concerning the examination of the amount to be enforced. It is a question regarding the ordering of enforcement proceedings that I will provide more details on in point IV.

4. Tough decisions on ordering enforcement based on foreign currency credit agreements incorporated by public notaries into public documents

The years of 2009 and 2010 meant a turning point from many aspects for public notaries, because – besides introducing new scopes of competence[50] – from 1 June 2010 the scope of entities involved in enforcement proceedings thus far was expanded by public notaries. According to the rules to be applied in proceedings launched after 01 June 2010, the ordering of enforcement by a public notary also applies to those notarial documents[51] , which contain:

[49] UJVÁRI: i.m. 368.

[50] Such as for example the termination of registered partnership by a public notary from 01 July 2009, the introduction of the registry for Partnership Declarations from 01 January 2010, as well as the proceedings for the order for payment and the European order for payment getting under the scope of public notaries' competence from 01 June 2010.

[51] In addition to ordering enforcement in connection with notarial document, the public notary also has responsibility regarding the issuance of the decision including condemnation made by a public notary, the agreement approved by a public notary, the list of costs on fees and expenses prepared by a public notary for performing non-contentious proceedings, furthermore, the enforcement form to be issued in case of a binding order for payment and a binging European order for payment.

- the unilateral declaration of liability regarding the service and consideration,
- the name of the entitled and obligated persons,
- the subject, quantity (amount) and legal title of the obligation, and the means and deadline for performance.

Therefore, the public notaries received the role of an authority ordering enforcement from this date on concerning all documents, which were previously prepared by them, and which had to contain the above-mentioned contextual elements. An additional condition for ordering enforcement based on such documents is that the claim incorporated into a notarial document should be the subject of judicial enforcement and the payment deadline for the claim has expired.

In one of his studies, *Zsigmond Balogh* public notary[52] said in regards to the above mentioned expansion of the scope of competence: *"I think we can declare it as a fact, that Hungarian public notaries could never feel the weight of the legislative sentence like this, according to which: 'Public notaries perform judicial magisterial activity as part of the government's judicial activity in their scope of competence specified by law.'"*[53]

It is a true and well-said thought, and it was already notable when it was formed that from this point on the public notaries will face a tough job containing numerous obstacles in this area of law. Later, it also surfaced that its deepest trenches were the proceedings ordering enforcement in connection with foreign currency credit documents.

The task waiting for public notaries was to create their own procedures based on the previous practice of court, but in accordance with notarial non-contentious proceedings. Although the practice of the court provided a guideline for the public notaries, however, its comprehensive, criticism-free application was not and is still not possible, because based on personal law interpretation public notaries shall make decisions based on their own financial liability in each case.[54]

For the purpose of creating standard practice for enforcement proceedings, for instance, it should have been fixed at the very beginning which public notary will act[55] during the proceedings ordering enforcement. §23/C of the ExAct. simply says that depending on the existence of formal and contextual requisites *"the public notary preparing the document"* is to add the enforcement clause to the notarial document. Guideline 29 of the Hungarian National Notarial Chamber (HNNC)[56] fine-tuned this seemingly obvious rule, which initially was still causing difficulties in practice. The guideline stipulates that the notary preparing the document must always be understood as the notary issuing the base document. For instance, the notary who exclusively cooperated in the amendment of the legal transaction not containing new commitment, or in incorporating termination into a document, is not qualified as the competent notary in the proceedings ordering enforcement.

52 Zsigmond BALOGH: *The daily life of a public notary adding a clause to a document.* Közjegyzők Közlönye (Public Notary Journal), 5/2014, 8.

53 Public Notary Act 1§ section (4)

54 BALOGH: i.m. 9.

55 The public notary does not have competence to execute the enforcement!

56 Hungarian National Notarial Chamber

The factor determining the person of the notary during the preparation of the enforcement clause in a credit transaction – that might even be amended several times – is whether or not the unilateral declaration of liability by the debtor based on the contract amendment or amendment incorporated into a public document contains new commitment. This rule has special significance in case of previously mentioned foreign currency credit agreements amended by an omnibus account credit, since it might happen that regarding legally completely connected legal transactions different public notaries order enforcement just because certain amendments contain additional enforceable declarations of liability. Its assessment is not always easy and it might even happen now that a law interpretation dispute arises among public notaries concerning the ordering of enforcement, in the question of competence. However, the vast majority is settled based on the principle of collegiality. This is actually needed as if, based on the above, the competent public notary to order enforcement is not, or not entirely, the notary who received the application for enforcement he shall transpose the case entirely or partially to the competent public notary. The parties may appeal against the decision ordering transposal. In absence of an appeal, once the decision ordering transposal becomes final and binding, the transposing public notary shall send the necessary documents to the competent public notary. If the case can only be partially transposed to another public notary, the receiving public notary calls the applicant for enforcement to submit possibly required further documents and to pay an additional fee. If the case is partially transposed, both public notaries shall issue the enforcement clause partly differently from the original claim.

In addition to the above, other questions also had to be clarified, which were not exclusively arising in connection with foreign currency credit transactions.[57]

One of the largest problems, from the perspective of enforcements in connection with foreign currency credit transactions, was that the the practice of courts developed differently regarding the adding of an enforcement clause to the notarial documents issued for the monetary claim defined in foreign currency, compared to how public notaries tried to establish it while practising their newly acquired scope of competence. Great support was provided for the public notaries in this topic by the Legal Council and the Committee on New Scopes of Competence of HNNC. The detailed system of rules prepared by them helped public notaries in what to do

(i) in case the claim in the transaction document is only defined in foreign currency without mentioning the currency of repayment; or

(ii) in case the claim in the transaction document is defined in foreign currency and the document specifically disposes of repayment in foreign currency; or

(iii) in case the claim in the transaction document is defined in foreign currency, but the document specifically disposes of the currency of repayment to be in forints, however,

[57] For those, who are interested in the topic, I recommend the FAQ published on page 65–70 of the Közjegyzők Közlönye (Public Notary Journal) 4/2010, the listed questions in which arose in public notaries in regards to the ordering of enforcement, for the possible answers to which were provided by colleagues having more theoretical experience in the topic. This is a good example of the knowledge sharing among public notaries, which by the way was always characteristic for the public notary profession.

it does not dispose of which exchange rate to recalculate it at, or disposes of having to recalculate it at the exchange rate upon repayment; or

(iv) in case the claim in the transaction document is defined in foreign currency and the document specifically disposes of the currency of repayment to be in forints, furthermore, the document also specifically disposes of which exchange rate to recalculate the claim at, and this date is later than the submission of the enforcement order, but it is not the payment date; or

(v) in case the claim in the transaction document is defined in foreign currency and the document specifically disposes of the currency of repayment to be in forints, further, it also specifically disposes at which exchange rate to recalculate it, and this date had already passed upon the submission of the enforcement order; further

(vi) in case of an enforcement request with contents contradicting the above.

The guidelines and recommendation of the committees also included how a public notary acts correctly, if the applicant for enforcement has a legal representative and if he acts without one.[58]

Another problem was the question regarding the issuance of an enforcement clause with a different amount than that listed in the termination. This also led to creating different practice among the public notaries. Part of the public notaries regarding this believes that they should only have a clause for the enforceable document for the amount which matches the amount listed in the termination. According to others, this practice is wrong, considering that when a lender terminates a loan agreement, his claim becoming mature upon the termination may be the same until the date when he is requesting the document to be equipped with an enforcement clause, but it might also be different from this amount. Based on my practical experience, the amount indicated in the termination and the amount listed by the lender upon launching the proceeding are in most cases different. The public notary however is not supposed to examine this, since it is also not mandatory to indicate the amount that matured and expired in the termination. The public notary shall compare the data of the enforceable document and the data of the application by the applicant for enforcement, and if the applicant for enforcement indicated a higher amount in the application than what would be due based on the enforceable public document, the public notary issues the enforcement clause differently based on §19 section (2) of the ExAct.

The initially different public notary practice leading to a phenomena is also connected to the above, when certain acting colleagues did not take into account that they are only entitled and obligated to examine the application for adding a clause to the document during the enforcement proceedings – within the tight boundaries of non-contentious proceedings – only formally regarding the existence or absence of formal and contextual requisites. Public notaries do not have to and shall not examine in the scope of the enforcement clause, if the loan agreement has been terminated in a private document by the applicant for enforcement

58 In case of an application submitted not by a legal representative, which has a specific failure, the court (public notary – ExAct. §) 31/E either supplements the insufficiencies by itself, or requests the party to do so, whereas wrong submissions by a legal representative shall be rejected without substantive examination.

before the termination was incorporated into the notarial document. Furthermore, the public notary has also no opportunity to decide which termination is effective. Similarly, it also cannot be examined in non-litigation proceedings for ordering enforcement, whether the debtor has later revoked his declaration of liability into a notarial document, or not. It happened frequently, therefore I will provide more details on this in point V.

It is important to record that over the recent period in addition to the above, additional practical questions could also arise in regards to adding an enforcement clause to the notarial documents containing foreign currency loan transactions. However, considering the topic of the study we are not able to demonstrate all questions which have arisen in more detail.

5. Escape attempts by debtors from their foreign currency credits: complaints, withdrawals, threats

Although due to the large number of transactions related to foreign currency lending the job of public notaries and the related legal problems to be solved also increased, most of the brainstorming, administration and unnecessary work was created by those – often identical – submissions which later spread widely. The persons creating these submissions also uploaded their document samples on the internet, so by using these the debtors – often instead of asking for real legal support – took their cases into their own hands and submitted their documents, sometimes without a specific application to the public notaries.

One of the shortest and most courteous sample applications, contextually containing factual and legal mistakes is the following: *"(…) Dear… Public notary, Please attach your authorization, based on which you contacted me in writing. As long as your entitlement is not proven, I consider your letter objectless. Best Regards: (…)".*[59] However, there were much longer submissions as well, accusing the public notary of a criminal act, or being almost tragicomic. They include the document sample titled *"Notice to certify the scope of competence"*, which is still available on the internet and I am quoting based on below in full:

"Case number: … Undersigned …, as a citizen of the legal Hungarian State, the Republic of Hungary, today I summon the authority to certify its scope of competence and right of jurisdiction with no delay and in itemised form, with legal arguments and the indication of the relevant legal provisions, based on Act CXL of 2004. 22. (1) and § 18. (1)! Also, please indicate those legal provisions, based on which you consider yourself an official person or authority! Further, please name the state, based on the behalf of which you carry out your above-mentioned proceedings! By providing an itemised answer on all three summons of this letter, please prepare your reply in your official proceedings, in an appropriate way and in the form of a public document, by ensuring that the formalities necessary for its authenticity are indicated at the right place! (name of the issuing authority, issuing person, title / position, handwritten signature, date, registration number, reference to this notice) ATTENTION! This notice is not a subject of the ExAct (Act LIII of 1994), and may not qualify as an enforcement

59 Source: http://www.devizaados.hu/index.php/adatvedelmi-es-adatkezelesi-szabalyzat/13-dokumentumok/212-kozjegyzonek-irhato-levelek

excuse, or other official submission format regulated by law, and may not be forwarded to the court! The court has no competence regarding this notice, either to requalify it, or to reject it, or even to approve it, since Act CXL of 2004 makes it the responsibility of the directly acting authority to examine the right of jurisdiction and the applicable law, which it shall officially investigate in all phases of its proceedings when it is questioned! Should it not comply with the principle of promptness, but latest within 30 days does not comply with the clear notice contained in this letter, it shall be considered as a fact of evidential value, that he has no right of competence and has acknowledged it in the affirmative."[60]

The HNNC certainly took the necessary steps when the author of the submission accused the public notary of committing a crime, or implying this by submitting a document to the public notary suitable for disgracing the reputation of the authority. Many public notaries still have to decide on a daily basis whether the submission they received can be assessed, whether it contains a real request, or it is so unclear that it is even incapable of rejection by a decision made in the form of formal verdict and it is efficient to be settled by a reply letter.

In my opinion, it can generally be the factor of assessing a submission – despite any contextual meaninglessness – on whether it contains a substantive request regarding specific proceedings. If the public notary finds that the submission contains a request to be assessed, it is practical to make a formal decision that can be appealed, by which it addresses the client's case by ensuring the opportunity for legal remedy. The method of addressing submissions including a request may be an informal reply letter. After a while, it should be limited by the fact that the considerable expenses arising from this by the public notary will never be compensated by anyone. Not to mention those recent cases, when the letter arrives at the public notary with unpaid postage, so in order to receive it he would have to take over the postage not paid by the client. I believe however, that the public notary cannot be forced to do so.

I think the list could go on for long, as the unlucky debtors losing their housing wished to find the responsible person at all cost, and the easiest authority in reach "with a human face" was the public notary. Such clients were not even afraid to appear in groups in the public notary's office with the method of applying personal pressure, and even though, as far as I know, no offence or crime was committed in these cases, their approach was still capable of scaring colleagues and hindering normal daily operations. And, when the foreign currency credit demonstrations started – the route of some touched on public notary offices as well –, there were some colleagues who were forced to keep offices closed for an uncertain time due to the demonstrators.

One of the prominent types of submissions and applications with complaints – but at least expecting the active collaboration of public notaries – was one, in which the debtor contacted the public notary to ask him to prepare a public document with the public notary attesting that the client appearing in front of him "*withdraws from the notarial document*" that the public notary previously prepared based on the request of the client, and which contained all commitments to repay the client's foreign currency loan. The "*withdrawal*

[60] Source: https://alkotmanyos-ellenallas.com/pub/VH_eljarasi_jogkor_igazolasa-v4-1.pdf

from the notarial document", or the *"revocation of the notarial document"* however are legally indecipherable, as only a legal declaration can be revoked. In many cases, the clients did not compose in a legally precise manner, however, based on their own statements, they promoted the revocation of the declarations of liability because they thought that it could help them to finally "get rid of" the credit. Moreover, they also hoped that if proceedings ordering enforcement took place against them, *"withdrawing" declarations,* namely those containing the revocation of the legal declaration would be taken into account by the public notary during enforcement.

The above expectations of debtors was however to no avail. The legal declaration can be revoked if the withdrawal declaration is received by the person who acquired rights with the declaration, latest at the same time of the revoked declaration. Afterwards, the withdrawal of the legal declaration is only possible if the other party, i.e. the opposing party in the legal relationship, has also consented to it. In case the client of the foreign currency credit withdraws his unilateral declaration of liability, it only comes into force if he announces it to the lender; further, once he announces it and it causes the withdrawing declaration to come into effect, to trigger a legal impact it is also necessary that the lender consents to the withdrawal of the debtor's declaration of liability in his reply. Basically, with this consent, it loses its effect, this makes the debtor's unilateral declaration of liability "withdrawn". So the great significance that clients' attributed to the withdrawal of their legal declarations regarding the repayment of their foreign currency loans was in vain, as – in absence of the lenders' consent – was ultimately not capable of triggering the expected legal impact.

For a short time, it caused disturbance in public notarial practice, how to treat such requests, prepare them, or refuse to participate. In the end, a reason for denying cooperation was not found, but since it was possible to precisely calculate the legal fate of such legal declarations – i.e. the declaration regarding the withdrawal of the legal declaration –, therefore I think it caused at least a moral dilemma for the acting public notary, whether to cooperate in preparing such a declaration, or not.

Additionally, it also had to be solved – if there were some public notaries who prepared the public document for the withdrawal of legal declarations – how the public notary, to whom the client submitted it in the proceedings ordering enforcement should manage it. Considering that the withdrawal of the legal declaration goes beyond the scope that can be examined upon ordering enforcement, following the initially varying practice, a consensus was formed among public notaries that it is not possible to delete the enforcement clause due to the *"withdrawn public document"*, or the *"withdrawn declaration of liability"* by the debtor. Due to the above, the debtor could not fundamentally count on getting rid of his credit by a single legal declaration – withdrawing the legal declaration in front of a public notary, incorporated into a public document –, the debtor had and still has a legal opportunity to initiate a lawsuit on terminating enforcement.

This study does not aim at comprehensively presenting various submissions by debtors. The above submission samples and described story fragments were only included in this study because nothing could demonstrate better how the daily transactions emerging based on the loans denominated in foreign currency impacted the daily lives of public notaries.

6. Inherited foreign currency

In addition to the preparation of transaction documents, attestations by protocol, and the ordering of enforcement by a public notary, succession proceedings also belong to those notarial proceedings, in which public notaries had to cooperate in the settlement of the legal fate of debt – the debts remaining from foreign currency loans, among others. According to the provisions of Act XXXVIII of 2010 on succession proceedings (hereinafter referred to as: SpAct),[61] succession proceedings are performed by public notaries, and if the SpAct disposes then the notary has competence for the given procedural action. Succession proceedings are such non-litigation proceedings upon which the public notary's task is to establish the identity of persons concerned as heirs, as well as the legal title of succession in regards to the assets and material share of the inheritance by his decision regarding the transfer of inheritance due to death. In order to do so, he has to explore the status of facts, including for example the kinds of assets the deceased left behind upon death. The subject of succession in all cases is the property of the deceased upon death, which *"is the total rights, things, liabilities (claims) and obligations connected to the deceased".*[62]

It follows from the above, that the obligation, i.e. the debt of the legato, is also the subject of inheritance, which is transferred to the heir. Based on experience in my work, I have found that heirs are generally also aware of this, and when they find out that there is a debt in the inheritance, they rather give up everything due to their fear that their own wealth will suffer from compensating the obligations of the legator and satisfying the lenders, and declare that they refuse succession. It is a fact that today the majority of the inheritance is almost certainly impacted by some credit, therefore the proportion of people rejecting succession over recent years has substantially increased. However, it does happen that the heir is better off making an agreement with the succession lender, so he can even be entitled to transfer the ownership title of some of the inheritance to himself. In addition, the misconception has spread that the debt of the legator entirely encumbers the heir, although *"(…) formally the obligations are also borne by the heir, however, his liability regarding the whole of his obligations of the legato is limited for the succession cum viribus or up to its value pro viribus."*[63] This means, that the heir is only liable for debt up to the inherited succession, i.e. his portion of inheritance. Consequently, his own wealth is fundamentally not at risk if he accepts an encumbered succession. At the same time, there is no doubt that one needs to act cautiously when satisfying the lenders, because if the heir does not possess the objects or benefits of the inheritance upon the enforcement of the claim, the heir is also liable with his other assets up to the value of the inheritance, therefore it is recommended to manage the inheritance with care until the claim against the inheritance lapses.

Additionally, the immediate refusal of inheritance is not necessarily practical as the refusing heir falls out of succession and will not be able to inherit anything later, even if it turns out during

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61 SpAct. § 3.

62 Tibor ANKA: *Right to succession – succession proceedings.* HVG-ORAC Lap- és Könyvkiadó Kft., 2014. 17.

63 ANKA: i.m. 17.

subsequent secondary succession proceedings that the legator still has an asset, the value of which is sufficient to settle the debts and may even be some remaining inheritance.[64] Moreover, if the refusing heir has descendants they will inherit the inheritance if they do not exercise their right to refuse it. Underage descendants only have an opportunity to reject the inheritance with the involvement of legal representatives and the consent of the guardianship office. Due to this, the proceedings may take years and become unnecessarily complicated if there are enough active assets in the inheritance left behind by the legator that would cover the debt.

Should the heir still refuse the inheritance, he can only do so once the inheritance is opened, i.e. after the death of the legator, and only until he does not specifically or implicitly waive his right of refusal. According to the provisions of the Civil Code, the taking possession of inheritance, or any other action regarding the inheritance shall be considered as waiving the right of refusal, which shows the heir's unquestionable will to accept the inheritance, furthermore, it is also considered as waiving the right of refusal, if the heir does not make a declaration to decline the inheritance before the deadline set by the public notary based on the request of any interested parties.[65] The declaration of refusal can be made in front of a public notary, or addressed to any co-heir, even without indicating the addressee, further, during or even before the succession proceedings. In case all traceable heirs – either legal or by a will – refuse the inheritance, it is transferred to the state as the necessary legal heir. Since the state has no right to refuse the inheritance, the final heir can be the state based on law.

The question often arises by heirs as to how to refuse the debt alone. It is humanly understandable that no one would like to assume the burden. In these cases, however, the answer is a disappointing one to heirs, since it is not possible to pick and choose from the assets of inheritance: if someone does not wish to inherit debt, in this case – with a few exceptions – the entire inheritance has to be rejected. One of the exceptions from the prohibition of partial refusal of inheritance is the inheritance of land serving agricultural purposes, the related equipment and inventories, animal stock and working tools. They can be refused if the heir is not professionally engaged in agricultural production and by its refusal the heir will not be hindered from inheriting the rest of the legacy. Nor is there any obstacle if the heir inherits based on a testament and law as well, he may refuse the portion acquired under one legal title independently.

During the succession proceedings, in addition to the refusal of inheritance, the question emerged regarding foreign currency credit transactions, what happens to the money which would have been due by the legator based on the so-called Settlement Act[66]. Of course, as the debt remaining from foreign currency credits, the amount owed due to settlement is also inherited, similarly to any other inheritance. There was a difficulty caused by the settlements only if the sending of the settlement letter based on law occurred during the succession proceedings, or once it was closed. In pending succession proceedings, there was no obstacle to incorporate the amount derived from settlement into the subject of the proceedings by the announcement of the

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64 SpAct. § 103 Section (2)

65 Cc. § 7:90. Section (2)

66 Act XL of 2014 (Settlement Act).

heirs. In case of succession proceedings already closed, there was an opportunity in secondary succession proceedings to add the amount of settlement into the items of the succession inventory.

Should any burden occur in the inheritance left over by the legator, instead of refusing the inheritance, it would always be more practical for the heirs to thoroughly consider which is greater in the inheritance, the active assets or the liabilities. Only with this knowledge can they arrive at the best decision. According to my experiences, however, the heirs often make a rash decision without sufficient information, by which they refuse the inheritance encumbered by credit, including foreign currency credit.

Summary

It may not be an exaggeration to state that the activity of public notaries can only be understood up-close by people who have spent a month or two in a notarial office, and who may be surprised by the fact that colleagues engaged in this profession in Hungary must operate with certainty in numerous areas of law to be able to perform their jobs at a high standard on a daily basis. By preparing this study, I tried to provide insight into the daily lives of public notaries: to present their job, dilemma, daily law interpretation hardships in various scopes of competence, as well as to demonstrate their subjectively experienced social judgement during a period when indebtedness due to loans denominated in foreign currency became a mass phenomena in Hungary.

Public notaries have contributed to the handling of cases by concluding as well as amending loan transactions, and in proceedings by ordering enforcement with respect to documents prepared by them, and are still collaborating regarding the latter today. Since the debt accumulated by certain clients resurfaces in succession proceedings, often encumbered by foreign currency credits also belonging to the competence of public notaries, they also administer foreign currency credit cases in a wider sense.

The penetration of loans denominated in foreign currency, as a social phenomenon, still has an impact in the professional lives of public notaries today because those debtors, who had enforcement proceedings launched against them, contact public notaries by serial submissions, due to which the solving of legal problems arising with foreign currency lending, as well as the closing of proceedings are still ongoing. So we can say, "the clearing of debris" might still take years.

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PUBLIC NOTARY ORGANISATION INTERNAL NORMS

Reminder on the joint session of the Judicial Committee and the Committee on New Competencies dated 21 November 2012

Guideline 29 of HNNC on the competence of public notaries in the proceedings ordering enforcement of notarial documents

COURT DECISIONS

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WHEN	WHAT HAPPENS	LEGAL REFERENCE
01 February 2015	**the settlement** of consumer claims in case of consumer credit agreements *denominated in foreign currency*, and in case of *foreign exchange* loan or credit agreements, which *do not qualify as being denominated in foreign currency* (record date: 01 February 2015)	Act XL of 2014. § 6. (5)
	amendment of consumer loan agreements by the power of law: § 10. The entitled financial institution based on the retail foreign currency mortgage loan agreement or denominated in foreign currency shall convert the entire outstanding debt established based on the settlement completed according to the Settlement Act, regarding or derived from the retail foreign currency mortgage loan agreement or denominated in foreign currency into forints by the deadline for the settlement obligation according to the Settlement Act – including any interest rate, fee, commission and cost charged in foreign currency –, on the a) average foreign currency exchange rate officially subscribed by MNB between 16 June 2014 and 07 November 2014, or b) the foreign currency exchange rate officially subscribed by MNB on 07 November 2014, whichever is more favourable for the consumer (hereinafter referred to as: conversion into forints). § 11. (1) If the retail foreign currency mortgage loan agreement or denominated in foreign currency is amended, the financial institution may only apply an interest rate indexed to the reference interest rate. (2) The applicable reference interest rate is the 3-month BUBOR. The contract amendment shall be effective on the record date [Act XL of 2014 § 6. (5)] retrospectively.	Act LXXVII of 2014. § 3. (1), (4), 10. §, 11. §, 20. (2)
	conversion of the consumer's **debt cancelled** by the financial institution – **but registered as default claim** by the financial institution or the financial institution belonging to the competence of the combined supervisory authority, established according to the settlement completed based on the Settlement Act – derived from the retail foreign currency mortgage loan agreement or denominated in foreign currency **into a claim denominated in forints**	Act LXXVII of 2014. § 15. (1)
	the document by the notary public with an enforcement clause can only be applied for based on amended retail loan agreement, and § 15 (1) **of the debt converted into forints**	Act LXXVII of 2014. § 4. (2) c)
01 March 2015 – 31 March 2015	the consumer may request settlement from the financial institution in case of a retail loan agreement concerned with *final repayment*	Act XL of 2014. § 10. (3)
01 March 2015 – 30 April 2015	**sending of the settlement** to the **consumer in case of loan or credit agreements** ***denominated in foreign currency***	Act XL of 2014. § 13. (1)
	sending of the text of the amended provisions of the loan agreement to the consumer along with the announcement of settlement (in case of loan or credit agreements *denominated in foreign currency*)	Act LXXVII of 2014. § 5. § (1)
within 30 days following the sending of settlement **to the debtor**	**the applicant for the implementation** (enforcement) sends the **announcement that the settlement has been sent** to the debtor along with the **settlement** (in case of loan or credit agreements *denominated in foreign currency*) to the **executor** – if the enforcement document has not been sent to the executor yet, to the **notary public**	Act XL of 2014. § 41. (1)–(2)
after 30 days following the sending of the announcement **to the executor (notary public)**	Act XXXVIII of 2014. § 17. the contents of §17 shall not be applied (in case of loan or credit agreements *denominated in foreign currency*)	Act XL of 2014. § 41. (1)
the day after receipt **of the** amended provisions **of the loan agreement by the consumer**	the **date of contract amendment** (except for retail consumer mortgage loan agreements in foreign currency or denominated in foreign currency, if the consumer did not request the waive of the conversion into forints) [*31st day following the receipt of the amended provisions by the consumer*], or requested it, but it does not meet any legal conditions [*day following the relevant notice*]	Act LXXVII of 2014. § 3. (3)
within 60 days after contract amendment	the **consumer may cancel** the retail consumer mortgage loan agreement *in foreign currency*, or *denominated in foreign currency*	Act LXXVII of 2014. § 13. (1)
within 30 days of receipt **of the** amended provisions **of the loan agreement by the consumer**	the consumer may initiate **the waiving of conversion into forints and the application of rules regarding interest rates**	Act LXXVII of 2014. § 12. § (1)
within 30 days following the receipt of settlement by the consumer	the consumer may lodge a complaint with the financial institution if he disputes the settlement	Act XL of 2014. § 18.
within 15 days following the sending of settlement to all concerned consumers	the financial institution publishes the fact that the settlement was sent to all concerned consumers on its website	Act XL of 2014. § 16. (3)
within 60 days following the publication of the fact of the settlement on the financial institution's website, but latest	the consumer may lodge a complaint with the financial institution, if it has not settled with him, and the settlement obligation is applicable according to the consumer	Act XL of 2014. § 19.

by 31 December 2015		
30 June 2015	**settlement** of the consumer's claim in case of retail loan agreements *denominated in HUF* (record date: 30 June 2015)	Act XL of 2014. § 6. (5)
01 August 2015 – 30 September 2015	**sending of the settlement** to the consumer in case of loan or credit agreements ***denominated in HUF*** or ***foreign exchange*** loan or credit agreements, which ***do not qualify as being denominated in foreign currency***	Act XL of 2014. § 13. (2)
	sending the text of the amended provisions of the loan agreement for the consumer along with the announcement of settlement (in case of loan or credit agreements *denominated in HUF* or *foreign exchange* loan or credit agreements, which *do not qualify as being denominated in foreign currency*)	Act LXXVII of 2014. § 5. (1)
within 30 days following the sending of settlement to the debtor	**the applicant for the implementation** (enforcement) sends the **announcement that the settlement has been sent** to the debtor **along with the settlement** (in case of loan or credit agreements *denominated in HUF* or *foreign exchange* loan or credit agreements, which *do not qualify as being denominated in foreign currency*) to the **executor** – if the enforcement document has not been sent to the executor yet, to the **notary public**	Act XL of 2014. § 41. (1)–(2)
after 30 days following the sending of the announcement to the executor (notary public)	Act XXXVIII of 2014. § 17. the contents of § 17 do not need to be applied (in case of loan or credit agreements *denominated in HUF* or *foreign exchange* loan or credit agreements, which *do not qualify as being denominated in foreign currency*)	Act XL of 2014. § 41. (1)
the day after receipt of the amended provisions of the loan agreement by the consumer	the **date of contract amendment** (except for retail consumer mortgage loan agreements in foreign currency or denominated in foreign currency, if the consumer did not request the waiving of the conversion into forints) [31st day following the receipt of the amended provisions by the consumer], or requested it, but it does not meet any legal conditions [day following the relevant notice]	Act LXXVII of 2014. § 3. (3)
within 60 days after contract amendment	the **consumer may cancel** the retail consumer mortgage loan agreement in foreign currency or denominated in foreign currency	Act LXXVII of 2014. § 13. (1)
within 30 days of receipt of the amended provisions of the loan agreement by the consumer	the consumer may initiate **the waiving of conversion into forints and the application of rules regarding interest rates**	Act LXXVII of 2014. § 12. (1)

by 30 November 2015	**sending of the settlement** for the consumer in case of retail loan agreements concerned with *final repayment*	Act XL of 2014. § 13. (3)
31 December 2015	the lender of the consumer may ask **National Asset Management to initiate the preparation of the settlement** in case of *retail loan agreements concerning residential properties offered for sale for National Asset Management*	Act XL of 2014. § 11. (2)
by 28 February 2016	**sending of the settlement** to the consumer in case of *retail loan agreements concerning residential properties offered for sale for National Asset Management*	Act XL of 2014. § 13. (4)

the applicant for implementation (enforcement) **reports to the notary public**, that	**he settled** with the debtor	**1.** the applicant for implementation (enforcement) reports the completion of the settlement to the notary public **along with the** implementation (enforcement) **request**	the applicant for implementation (enforcement) **attaches** the settlement	the implementation (enforcement) request **is aiming at more** than the claim according to the settlement			**rejection** of the implementation (enforcement) request
				the implementation (enforcement) request **is matching** with the claim according to the settlement			implementation (enforcement) **order**
			the applicant for implementation (enforcement) **does not attach** the settlement, only reports that he settled with the debtor	**notice to supplement missing documents** by attaching the settlement	**Sends** the settlement to the notary public	The execution request **is aiming at more** than the claim according to the settlement	**rejection** of the implementation (enforcement) request
						the implementation (enforcement) request **matches** the claim according to the settlement	implementation (enforcement) **order**
					does not send the settlement		**rejection** of the implementation (enforcement) request
		2. the applicant for implementation (enforcement) reports the completion of the settlement to the notary public **after the submission of the implementation (enforcement) request, but before the implementation (enforcement) is ordered**	the applicant for implementation (enforcement) **does not attach** the settlement, only reports that he settled with the debtor	notice to supplement missing documents by attaching the settlement (*the Notice to supplement documents and also the rejection without a notice to supplement documents can be derived from law*)	Sends the settlement to the notary public		see *
					does not send the settlement		**rejection** of the application for execution
				rejection of the implementation (enforcement) request *(the Notice to supplement documents and also the rejection without a notice to supplement documents can be derived from law)*			
			the applicant for implementation (enforcement) **attaches** the settlement, as a result of which *	his claim **does not change**	execution **order**		
				his claim **changes**	**amended** implementation (enforcement) **request**	**is submitted**	implementation (enforcement) **order**
						is not submitted	**rejection** of the application for execution
				there is no more outstanding claim	implementation (enforcement) **request**	**is revoked**	**terminate** the implementation (enforcement) procedure
						is not revoked	**rejection** of the execution request
		3. The applicant reports the settlement to the notary public **after the implementation (enforcement) order**	the notary public **already sent** the implementation (enforcement) document to the **executor**	the party applying for implementation (enforcement) **attaches** the settlement	**settlement is forwarded** to the executor		
				the applicant for implementation (enforcement) **does not attach** the settlement, only reports that he settled with the debtor	**forward the report** to the executor, the executor will ask the applicant to supplement missing documents		
			the notary public **has not sent** the implementation (enforcement) document to the **executor yet**	the party applying for implementation (enforcement) **attaches** the settlement	**the settlement is sent** to the executor along with the implementation (enforcement) document		
				the applicant for implementation (enforcement) **does not attach** the settlement, only reports that he settled with the debtor	**forward the report** to the executor, the executor will ask the applicant to supplement missing documents		
	no settlement is needed with the debtor						

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EXPERIENCES OF DEFENDANTS IN LAWSUITS RELATED TO FOREIGN CURRENCY LOANS

1. What will be our topic, and how will it be discussed?

The economic (repayment) problems related to consumer credit became a legal problem around 2006[1] The legal disputes proliferating after the beginning of the economic-confidence crisis in 2008, more pronouncedly from 2011, are still ongoing at all levels of the judicial system with varying intensity and focus[2]. Therefore, the history of consumer credit lawsuits is not too long, and it has not been closed in any way.

When, during one of his journeys to Europe in the 1970s, the emblematic Chinese prime minister and foreign minister *Chou En-lai* was asked how he evaluated the impact of the Great French Revolution of 1789, according to urban legend, he answered, “It would be too early to say”. This wisdom[3] is also true for the lessons of foreign currency loan lawsuits: Due to the lack of perspective and full insight, as well as because of daily involvement, a legal representative can today only provide a temporary, partial and subjective evaluation to those interested in experiences from foreign currency loan lawsuits.

I would like to point out at the very outset that although “foreign currency lending” has become the main sin and the source of all evil for the public, and it is the foreign currency loan that kills, makes you stupid, and reduces you to destitution, statistical data show that repayment difficulties leading to legal disputes were not related to “foreign currency lending”, but generally to residential lending, more specifically to the high-level indebtedness of the population, as well as to the fact that, due to the economic-confidence crisis, the incomes of families simultaneously decreased, and their credit costs increased as a result of rising interest rates and deteriorating exchange rates.

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1 This was the year when, among other things, the report of the so-called Várhegyi Committee (Expert Committee for the Investigation of Retail Financial Services, led by dr. Éva Várhegyi), Recommendation No. 9/2006 of the Hungarian Financial Supervisory Authority (HFSA) on the Principles of Preliminary Information to be Provided to Customers and Consumer Protection for Retail Lending (see Sections 15–19 on unilateral contract amendments), and report OBH 2958/2006 of the Parliamentary Commissioner for Citizens’ Rights, also focusing on unilateral contract amendments, were published. It was not much earlier, in December 2005, that the Hungarian Competition Authority (GVH) published the results of its sectoral investigation on mortgage loans, which already mentioned the need to examine the fairness of the general terms and conditions (see Section 39 of the Executive Summary).

2 According to the data published by the National Judicial Office (OBH), on 30 June 2018, 4,200 so-called “foreign currency loan” lawsuits were pending before regional courts and courts of appeal; https://birosag.hu/sites/default/files/2019-01/dh_elemzes_2018_06_30_0.pdf. On August 31 2017, this number was 7,450; https://birosag.hu/hirek/kategoria/birosagokrol/devizahiteles-perek-birosagokon (downloaded on 03/01/2019) In November 2013, more than half of the cases at the Economic College of the Budapest Municipal Court were lawsuits related to foreign currency loan contracts. (https://birosag.hu/hirek/kategoria/az-obh-javaslatai-devizahitel-szerzodeseket-erinto-peres-ugyekkel-osszefuggesben; download: 03/01/2019)

3 In contrast to the well-sounding legend, the gloomy reality is probably that, in his answer quoted above, Chou did not think of the 1789 revolution, but of the student rebellion of 1968. https://mediamythalert.wordpress.com/2011/06/14/too-early-to-say-zhou-was-speaking-about-1968-not-1789/ (downloaded on: 03/01/2019)

Data from the Magyar Nemzeti Bank (hereinafter referred to as MNB) shows that, for example, in 2014, the year of the so-called foreign currency loan laws[4], the difference in the proportion of non-performing loans within a given portfolio was not as large as public discourse and public sentiment suggested. 22.8% of foreign currency mortgage loans were overdue for more than 90 days, and this proportion was quite high among HUF mortgage loans as well at 13.3%. In the case of other foreign currency loans, the non-performance rate was 17.1%, which was not considerably higher than the non-performance rate of 14.6% for other HUF loans.[5]

Although, as described above, repayment difficulties affected consumers with HUF loans nearly as much as those indebted in foreign currencies, proceedings against creditors were almost exclusively initiated by the latter. Therefore, in this study, I refer to such proceedings as foreign currency loan lawsuits in spite of the fact that several issues discussed could as well be related to HUF lending.

2. What experience has been gathered?

Even if no final balance can be drawn, considering and evaluating experience from previous litigation is already useful because this will help us not to forget those lessons, for example, due to constantly shifting focus on new developments.

This study does not aim to analyse in detail the points of law raised in courts or the economic environment of foreign currency lending. The study is specifically based on the litigation experience of the legal representative of a defendant (bank[6]). This is the perspective from which the subject matter is examined, and the study tries to draw, and present to the reader, some generalizable lessons that may be relevant for the future.

As said, both the presentation and the selection of the experience discussed here is highly subjective. The study does not mention, for example, that, after cases related to parking, foreign currency loan lawsuits have also shown that the tools and approaches currently available are not

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4 Act XXXVIII of 2014 on the resolution of questions relating to the uniformity decision of the Curia regarding consumer loan agreements of financial institutions is referred to as "DH1" or the Act on "unfairness", Act XL of 2014 on the rules of settlement provided for in Act XXXVIII of 2014 on the resolution of questions relating to the uniformity decision of the Curia regarding consumer loan agreements of financial institutions and on other related provisions is referred to as "DH2" or Act on "settlement", Act LXXVII of 2014 on settling certain issues related to the conversion of the currency of certain consumer loan agreements and to the rules governing interest rates is referred to as "DH3" or Act on "HUF conversion", and Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables arising from certain consumer loan contracts is referred to as "DH4" or second Act on "HUF conversion".

5 See Figure V.2 of the Financial Stability Report of the MNB of November 2014. https://www.mnb.hu/letoltes/penzugyi-stabilitasi-jelentes-2014-november.pdf (downloaded on: 3/1/2019)

6 The term "bank" covers all financial institutions that provide financial loans as a business activity.

suited to manage mass litigation.[7] The lack of the constitutional sensitivity of competent courts is not described either, although surprisingly few councils pointed out the unconstitutionality of the regulation curtailing the procedural rights of plaintiffs in presumption rebuttal lawsuits according to DH1. And even those that did were unsuccessful. It is also not discussed why the public prosecutor started to initiate proceedings of public interest only after settlement and HUF conversion according to the DH Acts and the relevant MNB investigations.

3. Unclarified basic concepts

Perhaps the first and most shocking experience was how little everyone knew about this field of expertise. At the beginning of foreign currency loan lawsuits, we were taken aback by the fact that areas of law such as foreign currency debt, general terms and conditions, invalidity, action for a declaratory judgement, which we thought were well-known to us, raised fundamental questions in litigation, the answers to which cannot be found in modern legal literature and practice. Moreover, where answers were already available, we found that bank lawyers had probably not placed enough emphasis on these matters in the course of drafting contracts.

3. 1. General terms and conditions

Standard contracts accelerating, simplifying and standardising the conclusion of contracts, as well as the legal problems arising from their use, appeared simultaneously with modern mass transactions. The conclusion of a large number of transactions could not be managed without standardising and pre-drafting contractual conditions. Due to the transaction costs arising from modification requests and legal and documentation risks, the amendment of conditions standardised by the issuing party is typically impossible. In the case of a standard contract, the contractual freedom of the requesting party who signs a contract with the issuing party becomes the freedom of concluding or not concluding the contract[8]. In the same way, the freedom of consumers in foreign currency lending also lay in the ability to decide which bank and what loan scheme (HUF or foreign currency financing, amount, term, APR[9], etc.) should be used.

7 The figures quoted in Footnote 2 really show a significant number of cases. However, similar workloads are not unknown elsewhere either, and they do not lead to unmanageable difficulties. In the Hessen region alone, with a population of 6.2 million, nearly 5,000 procedures are in progress before German courts in connection with the so-called diesel scandal (2018 data; https://www.lto.de/recht/justiz/j/olg-frankfurt-am-main-diesel-verfahren-anstieg-herausforderung/). In lawsuits related to foreign currency loans, some councils seek unnecessarily detailed evidence or suspend a procedure several times with reference to ongoing CJEU procedures, partly because of the practice used at second instance mentioned in Section 4.2, and partly due to solutions expected from higher levels. Unfortunately, this happens even if the subject matter of the legal action (which can no longer be amended) is not in connection with the CJEU procedure. In such cases, the customary verbal explanation is that unfairness should be revealed ex officio, so the given procedure may be relevant, irrespective of the contents of the lawsuit. The reopening of points of law that have already been closed is also a factor preventing the rapid processing of lawsuits. For example, 2/2012. PK Opinion v. FÍ 5.Pf.21.122/2013/10 on the possibility of unilateral amendments, or, for example, 6/2013 PJE and CJEU C-312/14 v. Budapest District Courts of the 2nd and 3rd districts 17.P.21.278/2016/8 on foreign currency loan as an alleged investment product.

8 See e.g. Péter TAKÁTS: *A szabványszerződések*. Akadémiai Kiadó, Budapest, 1987. 10.

9 Annual Percentage Rate (APR)

Act IV of 1959 on the Civil Code (hereinafter referred to as Civil Code of 1959) contained the rules for General Terms and Conditions (GTC) from its 1977 novel. Even so, due to arguments regularly mentioned by plaintiffs, judicial practice frequently had to declare, for example, basic principles, e.g. that general terms and conditions did not have to be signed separately, and especially not on each page. They already become part of the contract by stipulating in the contract signed by the parties that the GTC should be applied in their legal relationship.[10]

On the contrary, defendants argued, for example, that the reading of GTCs by a notary public should be considered an individual negotiation thereof. This reasoning also failed the test of judicial scrutiny.[11]

However, the main question in the case of general terms and conditions was whether it, i.e. the contract itself, could be unilaterally modified by the issuer (in our case the bank) and, if so, under what conditions.

3. 2. Unilateral contract amendment

The first major point of law on foreign currency loan lawsuits was related to the right to amend contracts unilaterally. This legal institution was not only challenged before civil courts. The National Electoral Committee had to decide on the certification of several referendum questions aiming to require the National Assembly to prohibit by law the subsequent unilateral amendment of loan contracts. The National Electoral Committee certified some questions of that kind, but the Constitutional Court finally annulled these decisions.[12]

The right to amend contracts unilaterally is a consequence of private autonomy and the freedom of contract, a means of ensuring the flexibility and stability of permanent legal relationships. The right to amend contracts unilaterally can ensure, for example, that the relationship between service and consideration, defined at the time of concluding the contract, does not change during the permanent legal relationship, despite changing circumstances. It also ensures that neither party has to terminate the contractual relationship due to changing circumstances, but it can be maintained under modified conditions.[13]

Discussions on the issue of unilateral contract amendments are particularly interesting due to the fact that the principles subsequently appearing in the uniformity decisions of legal practice[14] and in legislation[15] in this field were already known in the period before the crisis.

In legal practice, for example, it was an established position that unilateral contract amendment was only possible if there was an explicit contractual provision to that effect, i.e. if one of the parties was granted the right to amend contracts unilaterally.[16] In the field of financial services, this was also a consequence of the regulation applicable from the entry into force of Act CXII of 1996 on credit institutions and financial enterprises (rHpt. 210, Section 3).

10 The question was hopefully finally settled by Section III.1.b) of the explanatory statement to the Civil Uniformity Decision of the Curia No. 1/2016.

11 BH 2012/247., BH 2013/128.

12 See AB Decisions 111–113/2009. (XI.20.), AB Decision 975/H/2009

13 Similarly: Section [11] of Curia Pfv.I.21.135/2016/5.

14 Section 6 of PK Opinion 2/2012 and Part III, Section 2 of 2/2014 PJE

15 Subsection 1 of Section 4 of the DH1 Act

16 BH 1993/513., EBH 2001/438., see the text of the rHpt. applicable from 1 January 1997.

Judicial practice also clearly stated that the right to amend contracts unilaterally did not allow the introduction of new costs, charges or other similar burdens[17]. Judicial practice also required that the reasons, circumstances and allowed contents of unilateral contract amendments should be stated by the parties in advance in the contract.[18] It was also an expectation in judicial practice that the party unilaterally amending the contract should demonstrate the existence of the circumstances justifying the amendment.[19]

An arbitration award published in a journal entitled “Bírósági Határozatok” declared that, in the event of unilateral contract amendment, the other party should be given an appropriate transitional period.[20] For such cases, the rHpt. already required prior notice of 15 days already from its entry into force on 1 January 1997 (Section 210, Section 3).

From 1 March 1999, Item d) of Section 2 of Government Decree 18/1999 II. 5. ensured, through the rebuttable presumption of unfairness, that the consumer had the right of termination if the right to amend contracts unilaterally was claimed by the other contracting party. In this regard, it was later disputed whether Subsection 2 of Section 292, of the Civil Code of 1959, according to which the debtor was allowed to repay the loan at any time before the expiry of the term, triggered an express right of termination. However, the Supreme Court required a clear and explicit stipulation of the right of termination.[21]

It was an established practice of the Competition Authority, already at the outbreak of the crisis, that service providers should ensure the symmetry of modifications, i.e. in the event of a favourable change in circumstances, the consideration to be paid by the consumer had to be reduced accordingly.[22]

Based on the above, it seems to be clear that subsequent legislative products cannot really be considered a novelty since most of the rules introduced by them were known and applied in legal practice already before the mass emergence of lawsuits related to foreign currency loans.

The conditions for the lawful unilateral amendment of consumer loan contracts were first summarised by the Curia in PK Opinion 2/2012. However, the later legal practice of the Supreme Court set expectations in individual cases that actually rendered lawful unilateral contract amendment impossible.[23] Recently, by means of its Civil Uniformity Decision No. 2/2014, the Curia tightened the conditions previously set up by itself to an extent that they became unfulfillable.

It turned out in the presumption rebuttal lawsuits, according to Subsection 1 of Section 4 of the DH1 Act, that over the decade following 1 May 2004, there had not been a single financier at any point in time that could draft its general terms and conditions regarding

17 EBH 2001/438.

18 BH 1995/414.

19 BH 1990/24. As a consequence of this principle, as the court argues, unilateral contract amendment can be reviewed in each specific case. For example, the Supreme Court declared in a lawsuit that the interest rate determined by exercising the right of unilateral amendment could not be disproportionately high (BH 1999. 176.).

20 1999/8. VB Decision

21 EBH 2009/2056.

22 E.g. 110/1995 VJ

23 Pécs Court of Appeal BDT 2013/3013. This decision was commented by attorney-at-law dr. György Léhmann, already deceased, saying it had destroyed foreign currency lending; https://alfahir.hu/osszedontottem_a_devizahitel_szerzodest. Although foreign currency lending did not actually collapse, under such conditions unilateral contract amendments virtually became impossible.

the right to unilateral contract amendment in a way that met expectations. This statistically improbable result was actually predictable due to the fact that the head of the Civil College of the Curia already stated at the press conference following the passing of PJE Decision 2/2014 that *"the most important part of the uniformity decision is the section on unilateral contract amendments, because very few contracts will meet the strict conditions set in it".*[24]

3. 3. The essence of foreign currency debt and the difference between buying and selling rates of exchange

It was not only the legal advisors of creditors drafting the general terms and conditions that were inconsequent in the use of terms for foreign currency lending, but also the legislator. Section 1 of Part III of the explanatory statement to Civil Uniformity Decision No. 6/2013 actually describes the conceptual confusion that was characteristic of this issue.[25] Loose wording, such as "booked in a foreign currency" or "foreign currency-based" loan, was dangerous because they could even suggest that these schemes were actually HUF loan contracts with a value stability provision.[26]

In reality, however, in contrast to the obstinate presumption of foreign currency borrowers dominating the media[27], creditors acquired the resources for foreign currency loans in foreign currencies, so they did not benefit from the worsening of the HUF exchange rate. Logically, banks were able to offer foreign currency loans with more favourable interest rates than in HUF because they used foreign currency resources with lower interest rates. It is irrelevant if the form of acquiring the foreign currency resource was a foreign currency deposit, interbank lending, bond issuance or currency rate swap (so-called swap transaction).[28] The bank had to settle accounts with the resource provider in the foreign currency, so they could not pocket

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[24] https://jogaszvilag.hu/napi/kuria-az-arfolyamres-tisztessegtelen/ However, the results of those lawsuits were rather traumatising for legal representatives because, for example, courts did not consider the terms of unilateral contract amendments lawful even in cases where they reflected the regulations set forth in Government Decree 275/2010 (XII. 15.) on the conditions for the unilateral modification of the interest defined in contracts.

[25] For more on the problem of concept definition, see also Csaba NÉMETH: *A devizahiteles perek joggyakorlati tapasztalatairól*. Gazdaság és Jog, 2014. Vol. 4. 3.

[26] For example, one week before the adoption of PJE Decision 6/2013 saying the opposite, this was how foreign currency loans were treated in Position No. 1, accepted at the professional meeting of the Civil College of the Budapest-Capital Regional Court of Appeal held on 9 December 2013, as well as in a specific case by the Szeged Court of Appeal; ÍH 2013/141.

[27] In spite of the consistent communication of banks during the lawsuits, the population was not publicly informed of the actual situation. For example, on 9 November 2011, the Hungarian Banking Association organised a press conference for 18 economic journalists with the participation of foreign exchange experts, informing them that the underlying resource of foreign currency loans is denominated in foreign currencies. The event practically did not appear in the press at all.

[28] As the Budapest Municipal Court established quite early, the actual source of the foreign currency in foreign currency lawsuits is completely irrelevant: *"the contract does not specify the source that the defendant is obliged or entitled to use to cover the loan, so the plaintiffs wrongly claim that banks should be required to provide evidence for their banking operations related to the provision of coverage for the loan. From a civil law perspective, it is irrelevant to the legal relationship what kind of credit market operations the defendant pursues or does not pursue as this is not covered by the contract, and there is no obligation in this regard" (67.Pf.640.687/2010/3.).*

the difference between the HUF equivalent of the loan calculated with the exchange rate at the time the loan was granted to the consumer and at the time it was repaid, and, in the event of an appreciation in the HUF exchange rate, they would not have had a loss from the difference.

In addition to economic considerations, the reconciliation of the term and foreign currency of the resource was also enforced by legislation and checked by the financial supervision authorities (HFSA and MNB) and by the auditor.[29] Loans granted in foreign currencies within the framework of retail lending were therefore loans leading to actual foreign currency debt.

This was not changed by the fact that, according to Subsection 1 of Section 231, of the Civil Code of 1959, foreign currency debt had to be settled (paid) by both parties in HUF. [30]Accordingly, pursuant to Subsection 2 of Section 231, of the Civil Code of 1959, the parties had to settle accounts at the place of performance, i.e. in the branch office maintaining the debtor's account, at the exchange rate valid on the day of performance.

Although it is a premise in market economy that a trader buys cheaper than he sells for, the fact that the buying and selling rates were also different for foreign currencies was a surprise for both foreign currency debtors and the competent courts. This was probably caused by the fact that, on the one hand, the consumer is the seller of the foreign currency amount at the time of disbursement, and the buyer at the time of repayment, and, on the other hand, money in an account is a balance, not a physical object. Therefore, the activity of exchanging money between accounts (currencies) was interpreted as simple conversion. However, if we accept the fact, in line with the reality, that a foreign currency loan is based on an actual foreign currency resource, then we also have to accept that the acquisition and holding of money in the account (foreign exchange) is associated with costs in the same way as cash (currency). The difference between the two rates will cover these costs, risk, and, let's not be shy, profit of the trader.

In spite of the above, the Curia explained, unfortunately without giving detailed reasons for their position, that the use of the buying and selling rates is unfair, because (among other things) *"the allegation in Section 1 of PJE Decision 6/2013, already referenced, is of decisive importance, saying that, in the case of foreign-currency-denominated loans, there is no exchange, just conversion at the time of disbursement and repayment. The determination of the conversion rate is necessary to ensure that the contract can be fulfilled. The use of different rates is not associated with any service actually provided to the consumer. The use of different rates generates an income for the financial institution, without any transparent performance, and a cost for the consumer. Pursuant to the contractual provision on*

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29 Pursuant to Subsection 2 of Section 89, (2) of the rHpt, credit institutions shall ensure that their resources and assets are matched in terms of maturity and amount. The detailed rules for this are laid down in the implementing regulations then in force (e.g. Government Decree 366/2011 (XII. 30. on the determination of the liquidity level of credit institutions and on the regulation of the matching of foreign currency position maturity). Credit institutions report/reported their foreign currency positions to the central bank daily in an information provision table called "D01" (e.g. MNB Decree 32/2009 (XII. 1. on the information to be provided to the information system of the central bank, on information providers and on the method and deadlines of providing information). So-called open positions were sanctioned by legislation (e.g. Government Decree 244/2000 (XII. 24. on the determination of the liquidity level of credit institutions and on the regulation of the matching of foreign currency position maturity).

30 *Béni Grosschmid*, an outstanding Hungarian jurist at the end of the 19th century, was probably more frequently quoted by defendants in their submissions for foreign currency lawsuits than in the entire legal literature due to his distinction between the currency of infliction and payment.

the use of different rates, the financial institution generates an income, as also acknowledged by the co-defendant, without negotiating the contractual provision individually, unilaterally and unjustifiably, to the detriment of the consumer and generating a cost for him, without a direct service requiring payment, which is unfair"[31]. In reality, however, both currency conversion and foreign exchange conversion start with a calculation operation, followed by the transfer of cash (banknotes and coins) in the first case, and the transfer of a balance (of account) in the second case. The result of the latter does not appear materially, but that does not mean it is consequently not a service.

As an explanation to why the application of a different buying and selling rate is unfair, a tribunal chief judge quoted to me an example, which is very illustrative but has probably never occurred in reality, that if a debtor taking a foreign currency loan wants to repay it immediately after disbursement, then he will not be able to do so because the HUF amount paid to him is not enough for performance, i.e. for the purchase of foreign currency corresponding to the amount of foreign currency debt.[32] However, it can also be imagined very plastically that a producer sells all his apples to a trader and then wants to buy them back from the trader (for example, due to a better bid) using the amount received. In a market economy, no one is surprised that, due to the trader's margin, this is not possible since the money from the sale of the apples will not be enough to buy back the same apples. The principle of nominalism only suggests that one Swiss franc (or one apple) should correspond to one Swiss franc (or one apple), but the purchase price of the Swiss franc (or apple) is not necessarily the same as its selling price. However, while no one questions the legitimacy of a margin, the exchange rate spread is considered unfair in Hungarian legal practice related to foreign currency lending.

In its Civil Uniformity Decision No. 2/2014, the unfairness of the application of buying and selling rates was derived by the Curia from the assumption that the Civil Code of 1959 obviously referred to the official (middle) exchange rate of the MNB because *"there was no other exchange rate within the framework of bound exchange control"*. However, looking at the contemporary exchange rate charts of the MNB, it can be seen that the MNB also worked

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[31] See judgement No. Gfv.VII.30.160/2014/5 of the Curia in the so-called Kásler-case. The consistent application of the legal practice denying the service nature of currency exchange would mean the end of foreign exchange rates because it is not possible to make a theoretical distinction between foreign exchange operations associated with residential foreign currency lending and corporate lending, or foreign exchange operations in a single consumer transaction (for example, crediting tax refunds received from abroad in a HUF account), because, according to the quoted explanation of the Curia, it is "just" a conversion in both cases. Cf. Szeged Court of Appeal Gf.III.30.239/2014 and Gf.III.30.526/2014, which claim that the unfairness of the exchange rate spread should also be applied to non-consumer loans.

[32] The same idea also appeared in a judgement passed by the Szeged Court of Appeal in the so-called Kásler case one month before: *"However, it is unfair to include a provision as a result of which … the debtor is obliged to repay a higher amount of loan than was actually disbursed by the lender"* (Pf.I.20.052/2012/7.). The Szeged Court of Appeal qualified the purchase and sale of foreign exchange as a virtual service, for which virtual consideration is to be paid; BDT 2012/2739. The Court of Appeal did not explain what that virtual consideration should be, but they probably did not mean virtual money (e.g. bitcoin), but a kind of folktale-like solution such as the ringing sound of coins shaken in the hands.

with buying and selling rates of exchange, just like today's commercial banks[33]. Moreover, the one-tier banking system did not appear in its pure theoretical form, since the Financial Institute Centre and the Hungarian Foreign Trade Bank already existed and performed foreign exchange transactions. In 2014, the MNB no longer listed buying and selling rates, but, through a specific averaging of market rates, published a price for information purposes only, which was not even necessarily applied by the MNB in its transactions.

It is really debatable whether it is fair to modify the spread between the buying and selling rates during the term of the loan[34] if the other party has no possibility to purchase the foreign currency from another (cheaper) source, or if this is prohibited by the contract. However, in the light of the above, it was a decision of the Curia and the legislator that it is professionally unjustifiable in a currency-liberalised market economy and incompatible with Subsection 2 of Section 231, of the Civil Code of 1959[35] that banks had to settle accounts with consumers retroactively based on the (middle) exchange rate of the MNB.

For the sake of factuality, it should be recalled that, in the case of consumer loans, it was not the Curia, and not even the DH1 Act, that abolished the margin of foreign exchange trade in 2014, but this was already done by Subsection 1 of Section 200/A of the rHpt., registered in November 2010.

4. Just carefully!

Carelessness and haste lead to bad results. However, politics is forced to act, and, due to procedural deadlines, courts do not always have enough time to find the right answers in terms of both derivation and result. There are several examples of the consequences of carelessness in lawsuits related to foreign currency loans.

4. 1. Be careful with good ideas

According to a saying often cited in German legal literature, entire libraries become useless after three clarifying words by the legislator.[36] However, the legislator rarely recognises his mistake. A refreshing exception is the new Code on Civil Procedure[37], Section 167–168 of which was supplemented with an explanatory statement saying that the requirement of documenting pre-trial consultation was a useless provision: *"The regulation on the requirement to attempt out-of-court settlement on a mandatory basis according to Section 121/A of the applicable Pp. is abolished by the proposal because in practice it has not met the positive expectations attached to it."*

33 For example, at the time when the final version of the Civil Code of 1959 was prepared in the competent ministry, according to the announcement valid on 5 May 1959, the MNB bought one rouble for HUF 2,913 and sold it for HUF 2,957, while one US dollar was bought for HUF 11,652 and sold for HUF 11,828. Indeed, it can hardly be imagined that, in the era of exchange control, the MNB bought the foreign exchange, offered by companies on a mandatory basis, for the same amount for which it could be bought from the MNB in exceptional cases.

34 Cf. the facts according to the Economic Leading Decision of the Curia No. 10/2013.

35 Subsection 1 of Section 3 of the DH1 Act

36 *„Drei berichtigende Worte des Gesetzgebers, und ganze Bibliotheken werden zu Makulatur";* quotation from the 1848 lecture of Julius von Kirchmann entitled Die Werthlosigkeit der Jurispudenz als Wissenschaft.

37 Act CXXX of 2016 on the Code of Civil Procedure.

In cases related to foreign currency loans, this rule, which first seemed to be a good idea, led to a lot of unnecessary litigation and caused, if the trial was lost, considerable costs for plaintiffs, who were typically already in a difficult financial situation.

The draft of the new Civil Code contained a special rule overriding the provisions in Section 123 of Act III of 1952 (hereinafter referred to as Code of Civil Procedure of 1952) 123, declaratory trial. Accordingly, the party may request the court to declare the contract invalid, in whole or in part, even if it does not request the application of the legal consequences of invalidity. This provision, later included in Subsection 2 of Section 6:108 of Act V of 2013 on the Civil Code, for reasons that cannot be determined based on parliamentary documents [38], was so appealing to some MPs that in 2012 the rule was also adopted, by an amendment through a private member's legislative motion, to the Civil Code of 1959.[39]

Due to the date of the establishment of the legal relationship, the Civil Code of 1959 is applicable in lawsuits related to foreign currency loans, this provision made it possible for lawyers representing plaintiffs in such cases to initiate mass invalidity lawsuits with respect to the contract or, mostly for the purpose of reducing the duty to be paid, one or more of its provisions, without having to request the establishment of the legal consequences of invalidity[40]. Judgements admitting the claim (partly and typically in marginal issues) communicated a false image to the plaintiffs that, because the court established the (partial) nullity of the contract, their financial burdens would be reduced. However, this was true only in very exceptional cases. Nevertheless, such decisions proved to be an excellent marketing tool for the representatives of plaintiffs (see Section VI below for more details).

Section 239/A of the Civil Code of 1959 was a trap for defendants because, as established by Civil Uniformity Decision 5/2013 of the Curia, in order to avoid the declaration of invalidity without legal consequences, they should have admitted the claim and requested the establishment of legal consequences in a counterclaim. However, if the claim is admitted, the court does not have to take a position on whether the contested provision is actually invalid, so it would have become impossible for the court to clear disputed legal interpretations. There was no other option but to take the risk of losing the trial, and then to start another lawsuit for the establishment of legal

38 What could be established based on the general discussion was that the OBH opposed the amendment of the Act, and the Fidesz party supported it because they thought it would lead to the simplification of lawsuits; speech 231 by Dr. Imre Szakács on 5 May 2012. From the opposition side, Dr. András Schiffer attacked the proposal with the perverse logic that, in his view, it favours the banks as *"these financial institutions are better off if they agree separately with the parties to the litigation using corrupt practices than if a final judgement does not only stipulate that a given standard contract contains a deceptive, unfair provision, but also that, say, a decision of the Curia also describes the consequences of bank contracts including unfair terms"*; sitting on 23/May/2012, speech 239.

39 Section 239/A of the Civil Code of 1959, established by Act LI of 2012, effective from 26 May 2012.

40 The already unmanageable situation was consolidated by Subsection 1 of Section 37 of the DH2 Act, which stated that, in the event of requesting the declaration of the total or partial invalidity of contracts within the scope of the Act, the plaintiff had to request the establishment of the legal consequence as well. The decision of the CJEU in case No. C-118/17 misunderstands this provision, based on information provided by the referring court pursuant to Section [53], since the applicant may claim the establishment of any legal consequences.

consequences (including the declaration of invalidity).[41] However, this would lead to the doubling of lawsuits, which is contrary to the alleged goal of the legal regulation regarding simplification.

Also, the explanatory statement to the draft of the new Civil Code does not explain why the procedural rule on actions for a declaratory judgement had to be ignored. It was not clarified as to why it was legally acceptable that a plaintiff could only ask for a declaration when the declaration of invalidity necessarily results in a settlement relationship[42]. Indeed, it is obvious to all lawyers that parties who have already litigated against each other, and who have completely different interests, will not settle accounts voluntarily and in mutual cooperation.

Although the purpose and rationale of the rule in Subsection 2 of Section 6:108 of the Civil Code Constitution remain obscure in the explanatory statement to the draft, the explanatory statement to Act CXX of 2009, which did not enter into force, as well as the so-called Expert Proposal[43] already specify the reason for the provision in more detail, literally. The petitioner and the author refer to an alleged need for the practice and to the fact that this provision allows the parties to *"settle their often quite complicated settlement dispute out of court flexibly and peacefully in order to maintain their business or other relationship in the future"*. This concept is as naive as the continuation of the explanation is wrong, stating that *"If the parties do not show mutual willingness, they will usually request the court anyway to establish the legal consequences of the invalidity in the same lawsuit"*. As already mentioned above, it was not in the interest of the legal representatives of plaintiffs to request the establishment of legal consequences, because then it would not have been possible to sell the (partial) success as a victory. Moreover, the defendant could only have asked for the establishment of consequences if he had admitted the claim.

A view has meanwhile appeared in commentary literature admitting that the provision has not lived up to the expectations originally attributed to it.[44]

The real consequence of the provision is that the settlement of the dispute is delayed, the relationship between the parties deteriorates further, and, lacking an agreement between the parties, the number of cases increases. Ideally, the legislator should weed out this provision from the Hungarian legal system, similarly to the institution of out-of-court settlement required in the Code of Civil Procedure of 1952.

4. 2. Be careful with EU law

Directive 87/102/EEC of the European Parliament and of the Council on consumer credit was transposed into two legal regulations under the name consumer loan. The relevant provision is contained in Section 212 et seq. of the rHpt. and in Section 7 of Act CLV of 1997

[41] See e.g. the facts of case No. Gfv.VII.30.212/2018; https://kuria-birosag.hu/hu/sajto/nem-tipikus-tenyallasu-devizahiteles-perben-hozott-hatarozatot-kuria It is uncertain, however, how the declaration of validity a long time after the final declaration of invalidity affects additional safeguards.

[42] Not including the case of declaring the partial invalidity in the case of certain clauses of marginal importance.

[43] http://www.parlament.hu/irom38/05949/05949.pdf The provision in question was contained in Subsection 3 of Section 5:84 of the 2009 draft. See: Lajos VÉKÁS (ed.): Expert Proposal for the draft of the new Civil Code. Complex Kiadó, Budapest, 2008. 789. (explanation to Subsection 2 of Section 5:82.)

[44] See: Lajos VÉKÁS – Péter GÁRDOS (ed.): Comment on the Civil Code. Volume 2, Wolters Kluwer, Budapest, 2014. 1480.

on consumer protection. These parallel provisions were annulled by Act CLXII of 2009 on consumer credit (hereinafter referred to as Fhtv.), transposing Directive 2008/48/EC.[45]

Between 1997 and 2000, the relevant rules of the rHpt. made loan contracts, not including the elements listed in Section 213, contestable. The legal consequence of incomplete contracts was nulled as of 1 January 2001 according to the rHpt., and nulled from their entry into force according to the Consumer Protection Act.

None of the Directives underlying the Hungarian regulation made it mandatory to require such a serious legal consequence. For example, the Austrian law on consumer loan contracts from 2010 does not declare contracts invalid in the absence of mandatory content elements, but, in order to preserve the validity of contracts and create fair content, specifies what should replace the missing or wrong provision by operation of law.[46]

Although the extremely serious legal consequence chosen by the legislator turned out to be evidently mistaken in foreign currency loan lawsuits, the provision was only amended in February 2015.[47]

In addition to the transposition of EU Directives, the interpretation of EU legal practice, often formulated in a very complicated and elaborate manner, has also caused many problems. Besides the evidently differing interpretations of plaintiffs and defendants, unfortunately, Union courts also interpreted CJEU jurisprudence differently.

A good example of this is the question, whether the judgements of the CJEU suggest that, in addition to the provisions of the General Terms and Conditions brought before the court by the plaintiff, courts also have to examine other provisions of the GTC ex officio? The 5th Pf. Council of the Budapest Municipal Court of Appeal, which has otherwise made valuable contributions[48] to the issue of Member State liability based on EU law, thought this to be the case. Accordingly, irrespective of the claim in the legal action, the court has to examine all the provisions of the GTC and, if they find a provision in it that is thought to be unfair, they have to annul the judgement at first instance even if, in their view, the dismissal of the action was justified with respect to the provisions evaluated in it: *"In case No. C-397/11 'Jőrös-Aegon', the Court ruled that the Directive must be interpreted so that the court of a Member State is obliged to evaluate ex officio the unfair terms of a contract concluded with a consumer …As a consequence, the Court of Appeal had to examine and identify where the terms of the disputed contracts contain invalid terms based on Subsection 1 of*

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45 Considering that the Fhtv. applies to credit loan contracts concluded after 11 June 2010, the relevant provisions of the rHpt. are still applicable in lawsuits related to foreign currency loans.

46 According to Subsection 5 of Section 9 of the Verbraucherkreditgesetz, for example, the statutory interest rate is applicable if there is no interest or APR, or if the APR has been determined incorrectly, and it is lower than the APR resulting from correct calculation, the interest rates according to the lower APR must be applied. However, individual Member States were of course entitled to apply stricter legal consequences, cf. the facts of the case CJEU C-42/15.

47 See Section 5 of Act LXXVII of 2014 amending Subsection 5 of Section 16, which entered into force on 1 February 2015. Until then, judicial practice refined the indefensible situation because it accepted that Subsection 1 of Section 213 of the rHpt. leaves room for determining partial invalidity, cf. Section III.5 of 6/2013 PJE.

48 ÍH 2019/17., ÍH 2018/102.

Section 213, of the Hpt. and Subsection 1 of Section 209, of the Civil Code".[49] As this position was not followed by most second instance courts, the result of second instance proceedings was dependent on the assignment of cases in lawsuits where the dismissal of the claim by the court of first instance was justified regarding the grounds of invalidity stated in the application.

Furthermore, this legal interpretation raised unanswerable questions about the scope of the subject of the judgement. Indeed, if courts examine the entire GTC ex officio in order to find unfair provisions, does a final judgement in such a lawsuit mean that all other provisions of the GTC, which have not been annulled, are valid as they have been judged and evaluated by the courts?

Adopting the above position, legal actions and appeals by plaintiffs regularly contained a polite request, which was far from being categorical, saying that the court should identify, ex officio, the invalidity of the provisions not mentioned in the claim.

The Szeged Court of Appeal took the opposite view with respect to such ex-officio examinations: *"The ex-officio identification of the cause of nullity does not mean that the court automatically reviews all provisions of the disputed contract regarding any further grounds for nullity, in addition to those mentioned by the parties"*.[50] The Curia joined this position: *"You cannot deduce a plaintiff's position that, in a lawsuit for declaring certain provisions of the GTC invalid (not to be retained), the court should examine the invalidity of all or any provisions of the GTC not mentioned by the plaintiff"*.[51]

The above example also reveals that foreign currency loan lawsuits showed courts that the CJEU could be used to bring about a change in the jurisprudence of higher courts, which they considered to be inappropriate. For an outside observer, it seems that this was the reason why the Budapest Municipal Court of Appeal asked the fifth question in case No. C-51/17 and submitted a further claim (No. C-34/18). In case No. C-51/17, the CJEU did not confirm the obligation of ex-officio examination, but reaffirmed its earlier position that invalidity could only be established ex officio if the necessary legal and factual elements were available to the national court.[52] The CJEU did not impose on the courts to carry out this further research.

49 5.Pf.21.122/2013/10.

50 Pf.II.20.180/2014 (BDT 2015/3361), Pf.II.21.307/2015/5: "Contrary to the position of plaintiffs, Union law does not require national courts to comprehensively review the contracts forming the subject of proceedings before it for the annulment of a contract in order to determine whether it contains unfair provisions not mentioned by the parties"

51 Section [11] of Gfv.VII.30.112/2015., Pfv.VI.21.978/2016/4.

52 See: Section 90 of judgement No. C-51/17. From earlier times, see e.g. Section 35 of C-243/08: "*if the necessary legal and factual elements are available to them*". This is more or less in line with current Hungarian jurisprudence, according to which: "*The court is only required to identify ex officio obvious instances of nullity that can be clearly established as facts based on available evidence. To allow the declaration of nullity, the court may not seek evidence ex officio.*" [Government Decree No. 2/2010 (VI.28.), PK Opinion, Section 4.a]. Interestingly, the Budapest Municipal Court also turned to the CJEU, but with an opposite intent, see case No. C-511/17.

4. 3. Be careful with foreign examples

Ripple effect or, more precisely the lack of it, was one of the favourite expressions of politicians in so-called socialist countries in the 1970s. They wanted to suggest that the oil crisis then hitting Western European countries would stop at the border. Although, indeed, the kind of severe fuel shortage that could be seen in the West did not appear, its economic and political consequences naturally did not stop at Hegyeshalom.

The same cross-border nature is also a characteristic of legal ideas. It seems that today not only a lawyer[53] leading a debtor protection association from abroad but also the courts take into account the responses of foreign legal systems to problems similar to those seen in Hungary.[54]

Considering the different provisions of their Civil Codes, German and Austrian courts took a different position on whether the creditor could demand, in addition to the interest, for example a disbursement commission or handling charges. While the German Bundesgerichtshof (Federal Court) was of the opinion, for both consumers[55] and businesses[56] that the disbursement commission was an unfair fee, the Austrian *Oberster Gerichtshof* (Supreme Court) was of the view that other fees, e.g. a handling charge, may also be required in addition to the interest.[57]

The procedure for a preliminary ruling launched for the clarification of the possible unfairness of charging a disbursement commission and a handling fee is in progress under No. C-621/17. The decision of the CJEU will have to be taken into account in all individual cases initiated on this subject. So the situation will be similar to that already mentioned in connection with presumption rebuttal lawsuits, i.e. the banking system will know whether the general market practice is fair after nearly ten years.

According to the general opinion among Hungarian judges, it is not considered unconstitutional if the court determines the past content of a norm, even for general purposes, with a binding effect on all courts: *"legal interpretation reveals the original content of the law, so in this respect a retrospective effect is not applicable"*.[58]

The fact that a different attitude may appear in the case of a market practice that has not been disputed for decades is well illustrated by judgement No. XI ZR 147/12 of the Bundesgerichtshof from 3 June 2014 on so-called kick-back commissions. This was the decision where the Bundesgerichtshof stated that in

[53] For a presentation of the head of the Financial Consumer Protection Association for Financial Services (PITEE), the first organisation thematising the issue of the exchange rate spread as a cost, see „*A jogász, aki rést talált a bankok pajzsán*" in: https://index.hu/gazdasag/2014/07/29/lazar_denes_interju/ and „Az ügyvéd, aki meghúzta az OTP bajszát" in: Figyelő, Issue 2016/20, pp. 20-21 (The action described here was finally dismissed by the Budapest Municipal Court of Appeal under 10.Gf.40.040/2017/10-II.)

[54] What I mean here is not the applicable jurisprudence of the CJEU, but the jurisprudence of national courts. See, for example, Section of Curia order initiating preliminary ruling No. Pfv.VII.22.444/2016/11; http://hitelsikerek.hu/wp-content/uploads/2013/09/EDE-IX..pdf

[55] Judgement in case No. XI ZR 170/13

[56] Judgement in case No. XI ZR 562/15

[57] Judgement in case No. 6 Ob 13/16 d

[58] 34/2014. (XI. 14.) AB Decision, Section 96. 2/2012. (XII.10.) PK Opinion, Section 6, explanatory statement: *"It does not violate the prohibition of the retroactive application of the law if a court declares that a clause in the General Terms is unfair based on the provisions of the Civil Code in force at the time of concluding the contract for a reason which is subsequently governed on a mandatory basis by a separate law, possibly relying on experience from case law."*

the context of investment consultancy, the client should be informed of the commission received by the investment service provider for the sale of the instrument in any form or amount. However, because this complex issue was very controversial in jurisprudence, and several contradictory judgements were delivered, the court took the position that, in the event of a violation of this obligation in cases before 1 August 2014, the investment service provider could invoke the existence of an error in law, so they could not be accused of violating the regulations; therefore, no compensation had to be paid in case of an unsuccessful investment. Unfortunately, there was no ripple effect with respect to this attitude.

4. 4. Be careful with self-regulation

The Code of Conduct[59] negotiated[60] between the Government, the Hungarian Financial Supervisory Authority, the Hungarian Competition Authority and the Banking Association, as a kind of self-regulation[61] by the market according to Act XLVII of 2008 on the prohibition of unfair commercial practices against consumers, was signed by 13 credit institutions on 16 September 2009. The Code of Conduct entered into force simultaneously with the amendment of Section 210, of the rHpt., which means that Chapter III of the Act, containing a list of causes giving rise to unilateral contract amendments, was also applicable from 1 January 2010.

The banks signing and accepting the Code also knew that the Code of Conduct was not a law. However, the circumstances under which it was adopted suggested that its content was also recognised by the regulatory authorities as lawful and consistent with the desired market practice.

However, judicial practice did not attach any importance to the Code of Conduct and, overriding the consensus-based principles contained therein, virtually came to the conclusion that if it was not a law, it was nothing.[62] Judicial practice did not even consider the Code of Conduct for the interpretation of legal regulations, so it lost all its importance.[63]

59 Code of Conduct on the fair behaviour of financial institutions granting credit to the population; https://www.mnb.hu/letoltes/magatartasi-kodex.pdf

60 The compilation of the Code was the result of an agreement signed by the Prime Minister, the Minister of Finance, the Minister of Economic Affairs and the Chairman of the HFSA and the Hungarian Competition Authority, as well as the Vice President of the MNB, and the representatives of Hungarian banks at their meeting on 17 July 2009. The first draft of the Code was prepared by the HFSA by the end of July 2009.

61 *"2. For the purposes of this Act i) 'Code of Conduct' means an agreement or set of rules created in the framework of market self-regulation, which determines behavioural rules in relation to a particular commercial practice or business sector for undertakings that undertake to be bound by the Code (hereinafter referred to as 'compliance with the Code of Conduct')."*

62 BH 2012/41., 2/2012. PK Opinion

63 It is not too comforting either that Government Decree 275/2010 (XII. 15.) on the conditions of the unilateral amendment of contracts in terms of interest rates suffered the same fate in presumption rebuttal lawsuits. According to the judgments, unilateral amendments in compliance with the Code of Conduct were considered as unfair in the same way as those that recreated the rules of the Decree. The idea, which is in contrast to the partial judgment passed in the review procedure for the so-called Partiscum case (Gfv.IX.30.221/2011/6.), that contractual terms in line with the special rules of the Hpt. may be considered as unfair according to the Code of Conduct was explained in Section 2 of the explanatory statement to PK Opinion 2/2010. (For further information, see Gábor GADÓ: *A fogyasztói kölcsönszerződések egyoldalú módosítása tisztességességének változó megítéléséről*. Gazdaság és Jog, 2015. Issue 7–8, p. 14 and following pages.). The practice of tribunals also represented the position that a contractual term containing a list of causes in line with the law can also be unfair (ÍH 2014/147).

The legislative and regulatory authorities contributing to the drafting of the Code of Conduct and welcoming its adoption did not take action against this legal interpretation by the courts. Therefore, self-regulation, which intended to regulate the conditions for the right to unilateral amendment from the perspective of the banking system, in agreement with the government and regulatory authorities, proved to be self-deception.

5. Limited self-reflection, limited self-expression

Perhaps the most painful experience we have to point out is that, in retrospect, the banking system was not really able to properly treat legitimate criticism and some professional issues raised in lawsuits. The attitude to the right to unilateral contract amendment and insistence on its unlimited exercise must be mentioned as the first problematic point.

5. 1. Excessive insistence on unilateral amendments

I have already described my position on the right to unilateral amendment in Section 3.2. I would like to point out here that if a credit institution exercised unilateral contract amendment, for example, with general reference to a *"change in interest rates on the money and capital markets"*, it was immediately suspected to be abusing its contractual rights. However, the danger of amendments, which was not transparent for an outside observer, was taken seriously too late, because we insisted on the unquestioned practice of previous years in spite of the fact that its correctness was already questionable on the basis of contemporary jurisprudence.

A good example of the lack of self-reflection and self-restraint was the creation of the Code of Conduct, already analysed in more detail in the previous section. Here, the banking system fought a comprehensive one-sided list of causes, based on which the jurisprudence described in Section 4.4 was predictable. Under the cause *"changes in money market conditions and the macroeconomic environment"*, the Code of Conduct allowed the unilateral modification of interest rates and/or fees in case of virtually any market change.

In retrospect, it appears that less would have been more, i.e. if sufficient self-restraint had been used for self-regulation, the resulting rules may have been considered fair in examinations according to Section 209, of the Civil Code of 1959.

5. 2. The lack of proper explanation

Another such problematic issue, we assumed (assume?) in the lawsuits that the given acting council was as familiar with the points of law and the established practice as the lawyers of the defendants dealing with banking and collateral contracts in their daily work. Therefore, the defendants' side did not explain the absurdity of the plaintiffs' reasoning in every case.

A good example of this is the judgement of Council 17.P of the District Courts of the 2nd and 3rd districts, already mentioned in Footnote 7. The referenced judgement at first instance does not at all deal with Section 1 of Civil Uniformity Decision No. 6/2013 of the Curia and the decision of the CJEU in case No. C-312/14. An economic news portal even noted in connection with the explanatory statement to the judgement that *"the lawyer of the bank did not express a meaningful counter-opinion or the court did not find it worth* *discussing”.*[64] Indeed, it is difficult, but not impossible, to imagine that the acting council would not have covered these legal interpretations, which were different from its own, if the defendant had referred to them.

Of course, there are certain limitations to the simple explanation of operational banking issues. For example, in cases where, despite having the burden of proof, the plaintiff’s claim that the APR indicated in the loan contract is not accurate, we are often requested to use the four basic operations to prove that the calculation of the APR is correct in a way that it can be understood by the court.

According to its mathematical content, the APR is a so-called IRR (Internal Rate of Return) function. By definition, the APR is the so-called internal rate of return of the total cash flow, i.e. the interest rate at which the present value of the cash flow is 0. In other words, the APR is the interest rate at which the discounted amount of yields equals the aggregated net present value of one-off expenses. It is very difficult to calculate the APR by hand because it can only be done by approximation: we estimate the interest rate, use it to calculate the present value, and experiment further until the present value is 0 (so-called iteration). This is why the formula in the Government Decree does not indicate the calculation of the APR, but the calculation of the amount of loan reduced by the costs using the APR.

However, the specific mathematical steps used in the function for the calculation of the APR and whether the debtor understands the mathematical apparatus behind the result of the calculation is not relevant to the validity of the contract. Similarly, it cannot be relevant to the decision on invalidity whether legal representatives are able to explain to the court the operation of the function in plain language, using the four basic operations.

Therefore, the requirement of “understandability” in financial mathematics is often just an illusion. I sympathise much more with the pragmatic attitude which, as also suggested in Section 6 of the explanatory statement to PK Opinion 2/2012, assumes that in the case of loans and other banking operations, the use of certain technical terms without a detailed explanation is inevitable in the contract.[65] If the given term is not known to the other party, due to its obligation to cooperate, it is obliged to indicate this fact and ask for an explanation of the term, or possibly look for an answer to the question by itself or seek expert help before signing the contract. If someone fails to do so, this negligence will deprive him or her of the possibility of later professing not knowing the term. This real-life attitude was handled, for example, by Council Pfv.I of the Curia for treating the term “annuity loan”, which simply means that the instalments to be paid by the debtor are always identical, but there is a constant shift within these in the repayment rate of principal and interest in favour of the former.[66] The facts mentioned in connection with the APR are also true here, namely, that it is not relevant to the validity of the contract what specific mathematical steps are used for the calculation of the annuity, and whether the debtor, the legal representative, or even the court understands the mathematical apparatus behind the result of the calculation.

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64 https://azenpenzem.hu/cikkek/megis-befektetes-volt-a-devizahitel/3439/ (15/2/2019)

65 This is an attitude of the court manifested in individual decisions. See e.g. Szeged Court of Appeal BDT 2013/2889.

66 Pfv.I.20.945/2016/14. and Pfv.I.20.030/2017/6.

Although it is not closely related to the experience discussed here, the absurdity of insistence on the requirement of "understandability" in certain situations is well illustrated by the fact that, partly due to the lack of "understandability", settlements with banks after unilateral contract amendments that were declared unfair had to be carried out using the following formula:[67]

It is not only because of the position often expressed by foreign currency borrowers, but probably also due to the lack, or at least inadequacy, of explanation by defendants that it is not possible to get rid of the stereotype that, through foreign currency lending, banks passed on foreign currency risk to the debtors. Without any income denominated in a foreign currency, such debtors actually bear (suffer or enjoy) the effects of exchange rate changes, depending on the direction of change. However, this is not based on the "viciousness" of banks, but on the provisions of Subsection 1 of Section. 231, of the Civil Code of 1959, i.e. the decision of the legislator. It was not (foreign currency) creditors who passed on some sort of risk that should be borne by them to (foreign currency) debtors, but, due to the specific nature of foreign currency debt, foreign currency debtors bore that risk from the outset by operation of law. Nevertheless, the inflammatory use of the phrase "pass on", which encourages a condemning moral judgement, seems to be ineradicable from communication in foreign currency loan lawsuits.

In this field, it would have been useful to continue the lectures on foreign currency lending at the Hungarian Academy of Justice, an institution responsible for the further training of judges. For example, it was explained to the participants already at the first lecture that it was pointless to ask the bank to demonstrate it had actually acquired the currency provided as a loan, since banks acquire refinancing at portfolio level, rather than at the level of individual loans.[68] As an analogy, a greengrocer cannot prove with an invoice containing an identical quantity that he has purchased one kilo of potatoes specifically sold to a given buyer, because he did not actually buy the quantity purchased by the given buyer from one or more wholesalers, suppliers, but his entire stock. Unfortunately, after the lectures, the Hungarian Academy of Justice was attacked so intensely that the lectures held on 10 July 2012 were not continued.[69] Perhaps it would have been a better solution if representatives of foreign currency debtors had also been invited later to ensure that the accusation of one-sidedness can be averted. Of course, it was justified to doubt whether an effective dialogue would have developed at such a meeting.

5. 3. Fear of coordination

The third problem was the low level of coordination among defendants. At the time when the interest groups of foreign currency borrowers appeared and gained ground, there was initially some rivalry

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[67] Complete explanation: https://www.mnb.hu/letoltes/arfolyamres-atszamitas.pdf ; https://www.mnb.hu/sajtoszoba/hirek-2015-juniusig/a-magyar-nemzeti-bank-modszertani-iranymutatasa-a-fogyasztoi-szerzodesek-arfolyamres-semmissege-miatti-atszamitasahoz (15/2/2019)

[68] See e.g. the Decision of the Financial Arbitration Board (FAB) of 17 January 2013: *"Financial service providers manage a comprehensive mass of assets, rather than the loan of each client individually. Loans are not refinanced on an individual basis, but at portfolio level, meaning that a specific contract cannot be associated with a specific refinancing contract."*

[69] See, for example, the following websites: http://ahazapartja.hu/?p=1344, http://hitelesmagyar.com/index.php/forum/12/19621-birokepzo-akademia-a-bankszovetseg-oktatja-a-birakat ; http://komlomedia.hu/10-belfold/1489-ez-mar-europa-a-bankszovetseg-oktatja-a-birakat

among them. At the level of the legal representatives of plaintiffs, however, there was coordinated action from the outset. As a consequence, the templates for their documents instituting the proceedings were supplemented with each other's arguments for invalidity, and, after each successful case, the judgements concerned became known to the others almost immediately. Where the plaintiffs achieved even just partial success, the judgement was already referred to at the next hearing of all cases.

Contrary to the above, coordination and the exchange of information was and remained haphazard on the side of defendants. In my opinion, the reason for this is that, during this period, the Competition Authority conducted several cartel proceedings against banks and imposed fines amounting to billions of HUF even in the most unjustified cases such as the so-called "Bank Data" case. Presumably, this was the attitude that deterred the side of defendants from sharing with others the decisions passed in their own cases and their legal arguments used in litigation.

6. Business is business[70]

I have the impression that lawsuits related to foreign currency loans are now partly driven by the interests of the legal representatives monopolising these cases, and not only by the actual needs of the debtors in a difficult situation. Nevertheless, they were significantly set back in launching new lawsuits by the formalist lower court practice applied in connection with the introduction of the new Code of Civil Procedure, and the obligation to pay a fee for rejected claims until November 2018. However, today there are already standard claims that are accepted by the majority of courts.

At the beginning of litigations related to foreign currency loans, some well-meaning and excessively committed lawyers took control of the legal disputes of consumers in a difficult financial situation. One of the legendary lawyers in lawsuits related to foreign currency loans was *György Léhmann*, a colleague from Siófok who has since died, who considered the representation of foreign currency borrowers a worthy cause, rather than business.[71]

However, other types of legal counsels and lawyers also soon appeared among representatives, who put a lot more emphasis on possible revenue. It goes without saying that a legal representative performs his work for remuneration.[72] However, work should not be autotelic, it should be useful for the client. A notary's certificate of facts is a good example of useless litigation and the situation where all victories in lawsuits (even those partial) trigger further litigation and a mass modification of claims.

In the case published under No. BDT 2015/3420, the Debrecen Court of Appeal declared that *"the clause in the consumer contract stipulating that the consumer's debt is certified by an official deed issued by a notary public based on a unilateral statement of the contracting*

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70 In this chapter, due to the protection of personality rights, I will not use footnotes for all claims, but that does not mean that I could not document examples from my own practice based on official records.

71 See e.g. https://www.sonline.hu/somogy/kozelet-somogy/devizaperek-150-ugyved-vedi-az-allamot-lehmannt-kihagytak-568397/

72 To be more precise: Unfortunately, this is still not natural for courts. For example, in one of our winning cases, where we took part in five hearings and filed seven submissions, the Budapest Municipal Court charged a court cost of HUF 12,500 + VAT, which is a 25% development compared to the judgement of the Székesfehérvár Municipal Court delivered one year earlier. In these cases, the costs of the second instance procedure were similar. Today, this amount of money is not enough to repair a dripping tap. Unfortunately, similar examples could be mentioned at all levels of courts.

party was unfair".[73] However, irrespective of the fact that this clause is declared invalid by the court, by operation of law, the bank has the possibility of filing a notary's certificate of facts regarding the debt of the debtor according to its records and thereby ensuring the enforceability of the loan or pledge contract included in the official deed.[74] Therefore, such a judgement only has some marketing value, without any tangible advantage for the debtor. [75]

As far as court costs are concerned, it was much more favourable to (partially) win a lawsuit initiated due to partial invalidity in a trial for the termination of enforcement than in a declaratory trial.[76] This is because in such trials it was not possible for the court to apply any other legal consequence (e.g. the declaration of validity) than the termination of the enforcement procedure. Therefore, the reason for the failure of some foreign currency borrowers to pay their debts was not financial incapacity, but, presumably encouraged by their lawyers, the intention to refer to the alleged invalidity of a clause of the loan contract after the termination of the contract and the commencement of enforcement. This is the way some GTC lawsuits became enforcement lawsuits. This possibility was abolished by the legislator only from 1 January 2017 by requiring the initiation of a lawsuit according to Section 370/B of the Code of Civil Procedure of 1952.

From 2014, the legal position of the debtors' representatives suddenly changed due to the statutory treatment of the grounds for invalidity guaranteeing the success of the plaintiff (see DH Acts). Previously, even the amount of loan specified in the contract was claimed to be a general contractual term unilaterally determined by the defendant (bank). Afterwards, however, even the conditions of unilateral amendment were seen as provisions individually negotiated between the parties because the acceptance thereof by the court would have made it possible to exclude the contract from the scope of DH Acts.[77]

Various client acquisition events were organised to offset the trend of filing lawsuits, which became less pronounced after settlement and HUF conversion. Dunaújvárosi Hírlap, for example, reported the following on 22 September 2015: *"A presentation was held for people in a difficult financial situation in the building of Dunaújváros Chamber. The representative of a lifestyle consultancy firm from Budapest said their company had a large number of lawyers and a great deal of litigation experience*

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73 The Budapest-Capital Regional Court of Appeal delivered a similar judgment in cases No. ÍH 2017/132 and BDT 2017/3629, and then, presumably taking into account Economic Leading Decision 1/2018, developed it further in its decision No. BDT 2018/3813. The jurisprudence of Courts of Appeal was not uniform. For example, the Győr Court of Appeal passed a contradictory decision; Pf.IV.20.243/2016/5/I., Pf.IV.20.027/2017/4.

74 Subsection 2 of Section 112 and Item g) of Subsection 1 of Section 136 of Act XLI of 1991 on notaries public. According to CJEU Decision No. C-32/14, this type of enforceability was not contrary to EU law.

75 Perhaps it would be useful in such cases, taking into account the second sentence of Subsection 1 of Section 3 of the Code of Civil Procedure of 1952, to declare that the legal dispute was not in the interest of the plaintiff because its legal position did not change in the event of winning the lawsuit. Cf. ÍH 2018/57. Decision Head I, BDT 2018/138. Decision Head II.

76 For the resulting legal issues, see the Summary Report of the group of the Curia in charge of jurisprudence analysis: https://kuria-birosag.hu/sites/default/files/joggyak/osszefoglalo_velemeny_1.pdf downloaded on: 07/04/2019

77 The same purpose was served by reference to the non-existence of contracts or to the withdrawal from contracts (or from the statement acknowledging the debt). In this regard, however, lawyers in charge of these cases quickly recognised that Section 239/A of the Civil Code of 1959 made it possible to launch an action for a declaratory judgment only in the event of referring to invalidity. In the event of reference to the non-existence of a contract, the Curia also applied the principle of proper exercise of the right; BH 2018/230.

in this field. This includes cases in which individuals or companies took bank loans denominated in a foreign currency but disbursed and repaid in HUF. Based on what has been said, the problems of foreign currency loan contracts are far from being solved. According to the charts presented here by the consultancy firm, the legal packages for rescuing foreign currency borrowers result in a reduction of the instalment by maximum fifteen per cent, but support from the company's lawyers may yield a reduction of up to fifty-six per cent. Based on the presentation, the keyword is litigation! It is only a final court judgement that can declare all or some of the provisions of contracts concluded with banks null are void or motivate the bank to consider a contract as non-existing, to remove the mortgage from the property, or to terminate an enforcement procedure. … this is the only way that credit or leasing transactions can be definitively resolved in the case of existing, closed, terminated or enforced contracts. Without litigation, there is no chance whatsoever since the customer is not in a negotiating position against the bank, and the bank will not restore the lawful situation without litigation."[78]

The acquisition of clients through events with an inflammatory purpose under the age of awareness-raising is also taking place in modern media. All you have to do is have a look at so-called debt relief videos posted on media sharing websites and read the comments below. Inflammatory language also infiltrates claims and other submissions by plaintiffs. It is not unprecedented that, as in one of our ongoing cases, the plaintiff, in his amended claim, makes references to the fact that, in addition to the abuse of office, the head of the Civil College of the Curia could even have committed the crime of genocide.

A fresh example of encouraging litigation with inflammatory language was the way victory was communicated after the decision of the CJEU in case No. CJEU C-118/17. The representatives of foreign currency borrowers inform viewers about their legal interpretations, which I think is incorrect, in videos uploaded to YouTube.[79] The lawyer, who initiated the preliminary ruling as a judge and who now deals with lawsuits related to foreign currency loans today, comments on the decision in his statements published in the press that foreign currency debtors are now released from currency risk and expresses his hope that this decision will no longer be contradicted by the supreme courts,[80] reinforcing the false, but maybe for some people lucrative narrative that foreign currency borrowers are victims of collusion between courts and banks.

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78 Pages 1 and 6. Available: http://duol.hu/gazdasag/devizahiteleseknek-1727632, lat download: 7/4/2019. The presenter's name is indicated by three dots (…), but it is shown in full in the original article. According to press reports, other advisors were also promoting themselves through various presentations: https://24.hu/belfold/2019/03/06/ep-valasztas-toroczkai-laszlo-mi-hazank-mozgalom-devizahitel-gulya-tibor/ last download: 7/4/2019. The interest groups dealing with the problems of foreign currency lending also take care of the political representation of the issue. The "A Haza Nem Eladó Mozgalom" movement, which has already become a party, led by Árpád Kásler, entered the 2014 elections in several districts; http://hir6.hu/cikk/92964/kozel_100_valasztokeruletben_indul_kasler_arpad_partja In the 2014 parliamentary elections, the candidate of Jobbik was Andrea Damm, described by the president of the party as a kind of Jeanne d'Arc for foreign currency borrowers; https://mandiner.hu/cikk/20141216_devizahiteles_ugyvedet_indit_a_jobbik_veszpremben last download: 7/4/2019.

79 https://www.youtube.com/watch?v=dpp4S3eZFiM&t=10s and https://www.youtube.com watch?v=ohfY693Utwg&t=92s Excessive pleasure seems to be inappropriate in the same way as earlier in case C-51/17, because the CJEU reiterated a principle that had been recognised for decades, stating that a national law conflicting with EU law should not be applied by courts; e.g. case 106/77, the Simmenthal case. However, such improper application of law had not been prevailing practice even before that. See also: https://kuria-birosag.hu/hu/sajto/kuria-kozlemenye-az-europai-unio-birosaganak-dunai-ugyben-hozott-hatarozatarol.

80 E.g. interview in Klub Radio https://www.klubradio.hu/archivum/reggeli-gyors-201912-heti-adas-2338, from 66:50

This was not the first time the internet was used by lawyers dealing with foreign currency lending. For example, a representative calling himself "Dr. Kevin" tried to stand out from the crowd by publishing judgements with comments like *"Kevin the Emperor humiliates the bank☺"* on his website, which is unavailable at the time of writing this article.[81]

However, the business opportunity in cases related to foreign currency lending was not only recognised by some colleagues specialised in the legal representation of debtors. In 2014, presumption rebuttal lawsuits with the Hungarian State as the defendant also entrusted law firms with its representation at the market price.[82] In each lawsuit, the legal argumentation put forward by the lawyers of the defendants was almost literally the same, and presumably centrally compiled, but this did not prevent them from claiming court costs amounting to millions of HUF in each case. However, the courts did not find the claim for court costs reasonable in any of the cases, and only a fraction of the costs claimed was awarded.[83] Of course, this does not necessarily mean that state lawyers did not get the full amount of the charged fee from their client.[84]

In these cases, the Hungarian State also tried to maximise its revenue when it consistently imposed the obligation to pay the highest amount at all procedural levels for lawsuits for which no subject matter value is otherwise determined.[85] However, even this revenue was insufficient to cover the amount of HUF 2 billion 360 million allocated to state lawyers.

Incidentally, the highest hourly fee in presumption rebuttal lawsuits also appears in the legal representation of debtors. One of the lawyers charges half of this amount only for each started page of his submissions, but, in one case, he put forward a submission with 70 pages (HUF 25,400 * 70 = HUF 1,778,000).[86]

7. Outlook

At the beginning of litigations related to foreign currency loans, I naively assumed that the legal issues arising in the lawsuits would be definitively clarified in about two years and, from then on, the outcome of lawsuits would be more or less predictable, or maybe only the questions of evidence would be different.

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81 Web address: www.drkevin.hu See also https://hirtv.hu/panaszkonyv_adattar/alarcos-ugyved-1405488.

82 CHSH Dezső & Partners, Kovács, Barborják & Partners, Dr. Rátky & Partner, Réti, Antall & Partner and SBKG Law Firm took care of legal representation in lawsuits, while Jurasits Law Firm performed coordination tasks. https://hvg.hu/hetilap.hetnapgazdasag/201434_beindult_devizaperek; https://www.napi.hu/magyar_vallalatok/ki_nem_talalna_mennyit_kolt_a_devizaperes_ugyvedekre_az_allam.585948.html; about conflict of interest in the case of some firms: https://magyarnemzet.hu/archivum/belfold-archivum/osszeferhetetlen-ugyvedek-4007443/ and https://magyarnemzet.hu/archivum/vezercikk/devizahiteles-perek-ugyvedei-4006150/ last download: 07/04/2019

83 See e.g. https://magyarnemzet.hu/archivum/vezercikk/devizahiteles-perek-ugyvedei-4006150/ last download: 7/4/2019.

84 There was a trial where five "state lawyers" were sitting in front of me. It cannot be ruled out that the hourly account attached to their invoice contained the period of preparation and attendance at the hearing for all five of them.

85 Subsection 1 of Section 8 of the Subsection 2 of Section 13, Subsection 2 of Section 15 of the DH1 Act

86 In addition to the fee payable for the number of pages of the written text, he also charges an hourly fee of 25,400 HUF as litigation cost, as well as an additional success fee amounting to 10% of the subject matter value.

Taking into account the legal and tactical turning points in the history of lawsuits, I would no longer dare to predict when foreign currency loan litigation would come to an end and when there would be no more legal disputes. Perhaps it is only possible to make a list of conditions under which there is some hope for solving the problem.

The first and most important condition is that the financial and thus the housing situation of debtors in a difficult, often hopeless, position should be improved. In the current labour market situation, this does not seem to be impossible, but even so it could hardly be realised without active state participation, such as a tenancy program, or even the fundamental revision of the rules for private bankruptcy.[87]

If the first condition is met, the willingness to initiate lawsuits may diminish by itself, but it must also be ensured that the "industry" settled on foreign currency debtors is not excessively motivated to persuade those concerned to launch more and more (partial invalidity) procedures.[88] This can be supported by defendants formulating their legal arguments in as plain language as possible and in a compact form. The role of the courts may be to use a rapid decision-making process through a strict trial schedule. Thus, for example, they may evaluate plaintiffs' legal arguments that are already known and have been rejected several times quickly and decisively, already at first instance, or even at the first hearing,[89] and apply the method of annulment at second instance only to a limited extent. Furthermore, the chambers of lawyers have to take action against those members who do not provide their clients the required information on the chances of winning, the impact of winning on payment obligation, and the financial risk they face if the lawsuit is lost.[90]

Although I have criticised the legislator several times before, I must admit it was the correct decision to reflect on the judicial practice then already routinely applied to unilateral amendment right and exchange rate spread in a legislative, general-normative form. The future role of the legislator may be to respond quickly to similar situations and not to delay corrective action for years, as was done in connection with the legal consequences of the lack of mandatory content elements in consumer loan contracts or the clarification of the relationship between declaratory and enforcement proceedings.

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87 Act CV of 2015 on debt settlement for private individuals

88 I am unfortunately pessimistic in this regard. On the one hand, foreign case law shows that unfair clauses in general terms of contract prove to be an inexhaustible source, and there will always be one or two elements in a contract or in the terms and conditions of banks that qualify as invalid. On the other hand, the existing clientele can be easily mobilised if there is a new "hit". For example, the German case law presented in section 4.3 did not lead to mass litigation. Due to the antecedent, a similar decision would result in a flood of lawsuits in Hungary.

89 My experience was that even the least well-founded claims were accepted under the Code of Civil Procedure of 1952, and several hearings were typically held to find out the exact subject matter of the claim only. The opposite can often be observed during the New Code on Civil Procedure. Now it is not the difficulties of interpretation arising from the complicated structure and infinite length of the claims that prolong each lawsuit, but, quite the contrary, the fact that the party who acts personally, probably due to the simple acceptance procedure, initiates the lawsuit with minimum content based on Section 247, of the Act on Civil Procedure, and the legal representative presenting the usual argumentation appears only later. As a logical consequence, the defendant is unable to submit an adequate counter-petition for the claim.

90 Perhaps it is natural to require that this information should be at least as detailed as it is expected by the legal representatives concerned in the case of declarations of risks by banks.

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LEGAL EXPERIENCE OF RETAIL FOREIGN CURRENCY LENDING 2004–2010

[1] The author was Legal Director of FHB Jelzálogbank Nyrt. between 2001 and 2007.

1. Introduction

A defining moment – equally for borrowers, lenders, regulators and supervisory authorities – in the history of retail mortgage lending, after the regime change in Hungary, was the period of foreign currency lending[2]. These types of transactions were typical of the Hungarian retail mortgage market between 2004 and 2010. During these years, a portfolio of significant size had been built in Hungary. The excelling size of retail foreign currency loan portfolio has been addressed extensively, even in economic literature: *"At the end of the first half of 2010, the debt of Hungarian households totalled nearly HUF 10,600 billion*[3] *(equalling 40 per cent of the GDP). Within this, foreign currency debts amounted to approximately HUF 7,300 billion* [4]*(28 per cent of the GDP), which totals two-thirds of the total portfolio... Foreign currency loans achieved this high share in the portfolio in the second half of 2008, since then their share has been substantially stagnating and slightly decreased. More than 90 per cent of foreign currency loans are debts denominated in Swiss francs while 7 per cent is denominated in Euro."*[5]

These phenomena undoubtedly had and have national features – in particular those involving crisis management tools –, however, it should be noted that foreign currency lending was not exclusively a Hungarian speciality: *"…During 2011, the share of foreign currency loans within the retail loan portfolio in the different countries was the following. 90 per cent in Lithuania, 80 per cent in Serbia, 60 to 70 per cent in Latvia, Romania, Croatia and Hungary, 40 per cent in Bulgaria and Poland, 30 per cent in Austria, and interestingly or perhaps not interesting, nearly zero in the Czech Republic and Slovakia. This was the share of foreign currency loans within the retail loan portfolio in 2011, in Central Eastern Europe. Within this share of foreign currency loans, the share of Swiss franc loans was strikingly high in Poland, when compared to Austria and Hungary."*[6]

This seven-year period of the Hungarian lending history, that provides lessons even today, has already been analysed in several professional approaches and in a demanding manner. This study envisages tracing back the events – in specifically legal aspects – from their outset in 2004 until 2010. Our analysis focuses on the contracting practice and legal interpretations surrounding the then legislative environment, as well as the then trends, to find legislative and official solutions, by trying to form based on this a notion of the key features of the legal way of thinking characteristic of this period.

The key driving force of this effort is the experience that the development of law – both in the area of legislation and of the application of law – during the time that has passed since the shock caused by the foreign currency credit crisis and the time of borrowing, unwittingly distorts the opinion of the present day about the conditions of that time. The period chosen

2 The study uses the expression "*foreign currency lending*" basically to define retail foreign mortgage lending, and by following the everyday language, it does not make a distinction between the terms "loan" and "credit".

3 This is equal to ca. 33 bn EUR.

4 This is equal to ca. 23.74 bn EUR.

5 Tamás BALÁS – Márton NAGY: A devizahitelek átváltása forinthitelekre. *(Conversion of foreign currency loans to forint loans)* Hitelintézeti Szemle, 2010. Vol. 5. 416.

6 See: András Simor's oral information. In: Minutes of the meeting of the Sub-committee of the Parliamentary Committee on Constitutional Affairs, Justice and Procedures investigating to identify the causes of retail foreign currency indebtedness between 2002 and 2010 and to establish the possible responsibility of the government held on 3 November 2011, page 13. Available on the internet: https://www.parlament.hu/biz39/bizjkv39/AIB/A412/1111031.pdf

to be subject matter of the research entails also that the intended consequence of this study does not wish to describe the legal instruments applied during crisis management in order to manage the social level insolvency nor the extensive experience of lawsuits characteristic of the crisis. Separate studies in the volume are dealing with all these.

It is important to emphasize that the foreign currency loan crisis on the borrowers' side has, in many cases, experienced a trauma endangering even livelihood, while at the lenders' side, for the banker generation concerned, it brought about the traumatic experience of a crisis thus far unknown in size and loss. All these inevitably create for each concerned party their respective truth – influenced by the involuntary self-certification of their roles. Examining the legal aspect does not even require establishing the truth, it is only intended for sophisticated opinion by formulating a tone.

2. Legal principles

There had been no example for foreign currency lending within the scope of retail mortgage lending either during the socialist era of exchange controls or in pre-WWII lending practice. Despite this, the legal basis of foreign currency lending – i.e. in a currency other than the domestic legal tender – was clear and confident in dogmatic terms.

Correct establishment of the legal basis of foreign currency loan agreements rests on two pillars:

a) On the legal rules of loan agreement

During the entire term of the period examined, Act IV § 523 of 1959 on the Civil Code (hereinafter: 1959 Civil Code), effective with unchanged content, provided for the content of the loan agreement. This set out that contracting parties mutually undertake a payment obligation vis-à-vis where it is the lender's obligation to disburse a loan, while the debtor's obligation is to repay that amount, i.e. the principal and accrued interest, as well as any other fees and charges associated with the loan. With respect to the debtor's payment obligation, the unconditional character of repayment obligation is a fundamental rule. The underlying reason for this is that the lender itself had already met their obligation, i.e. had disbursed the loan to the debtor and the borrowed money must be paid back, thus, based on Paragraph (1) of Section 301 of the 1959 Civil Code, the debtor is obliged to pay default interest even if he excuses his delay.

These regulatory principles became of key significance within the scope of foreign currency lending, as under the pressure of mass payment difficulties the question arose at society level why only debtors must run the risk of changes during the term. Approaching this dilemma from the legislation, the answer is clear: *"Risks associated with a loan are always borne by the debtor in legal terms: the deterioration of his living condition, reduction of his income, increase of the costs of living, increase of market interest level, etc. are all changes, which although make it difficult to meet his contractual obligations, do not discharge thereof."*[7]

[7] István GÁRDOS – András NAGY: *A devizahitel jogi alapkérdései. (Basic legal questions of foreign currency loan)* Hitelintézeti Szemle, vol. 2013/5. 376.

b) On the rules of repaying a cash debt
Section 231 of the 1959 Civil Code – which had not changed during the period under examination either – set out an additional provision of key significance with respect to foreign currency loans. According to this
   - a cash debt shall, unless otherwise agreed by the parties, be repaid in the legal tender of the place of performance, furthermore
   - a debt specified in a different currency – i.e.: not in the domestic legal tender but in a foreign currency – shall be converted on the basis of the exchange rate prevailing at the place and time of payment.

This regulation specifies essentially the difference between the denominated currency and the paid currency which is a special and important feature of cash debt. *"If money was always made from the same material everywhere, the sum of a cash debt could be established as 'two kilograms of money'. If money was always made from the same material everywhere and in a uniform size and with the same inscription, i.e. in technically homogeneous individual items, a cash debt could be specified also as: '100 pieces of money'. However, as none of these assumptions hold, and this was not the case in the past and will not be in the future either, a cash debt or its sum cannot be specified differently as giving the amount in any of the type of goods, the equivalent of which will be the amount payable (generalissimum). This type of good whose value is equal to the amount to be paid by the debtor may be a specific currency, e.g. 100 dollars, or may be (which is the most common case) a given amount of the currency in which, expectedly and according to the normal course of economic life, repayment will occur (e.g. 570 pengő), eventually it can be any other type of good, gold, grain, etc. (e.g. debtor owes the counter value of 30 q wheat)."* [8]

By means of the above definition, we may draw two conclusions with respect to the Hungarian legislation:
- in the loan agreement parties could validly specify the cash debt not only in forints but also in any other foreign currency (the currency in which payment obligations are to be met = denominated currency);
- debts specified in foreign debts – unless otherwise instructed by parties – must be repaid in Hungary in forints, converted at the exchange rate valid at the time of repayment (the currency in which the payments are actually made = paid currency).

Fundamental proposition of this regulation is that parties are free to specify both the denominated currency and the paid currency. From this, specifying the currency of the debt, i.e. the denominated currency is a mandatory element of such an agreement, while parties are not obliged to provide for the paid currency. If they fail to provide for that, the debt must be repaid in accordance with the legislation (but certainly, there is no obstacle to specify in the loan agreement forint as the paid currency, but in the absence of this the legal effect is the same). If parties specify the paid currency as a foreign currency other than the Hungarian legal tender – be it with respect to the disbursement, repayment or both – that would also be a valid disposition (called an enforcement clause effective in a foreign currency).

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[8] Viktor BÁTOR: *Pénztartozás. Kamat. (Cash debt. Interest.)* In: Károly SZLADITS (ed.): Magyar Magánjog. Vol. III. Budapest, 1941. 242.

In the history of Hungarian foreign currency lending – obviously in close connection with unprecedented legal thinking that evolved in the absence of legal practice – a special and inconsistent use of terminology had evolved. At the level of practice, this meant primarily the use of the terms "foreign currency based loans" and the "purely foreign currency loans". By the end of 2010, but much more in the period following our examination, i.e. after 2010, this terminology popped up also in legislation in the form of "foreign currency based loans" and "loan recorded in foreign currency or loan granted in foreign currency and repaid in forints"[9], as well as "foreign currency credit" or "foreign currency loan not qualifying as foreign currency based loan".[10]

These definitions are considered foreign currency based loan (which, based on the frequency of its occurrence, represented the main category) where the payment obligation of both parties are specified in a foreign currency (denominated) – primarily in Swiss francs or euro – but debts must be typically repaid (paid off) both in the case of disbursement and repayment in forints. By contrast, in the case of the use of terminology for a foreign currency loan, not only denominated currency is a currency other than forint, but disbursement and/or repayment must be effectively made also in this currency.

The main flaws of these definitions are identified as follows:

(i) instead of specifying the debt they only provide for its recording by the lender, and
(ii) use the currency for meeting the lender's disbursement or the debtor's repayment (paying off) obligation as an essential element.

Indeed, it is irrelevant to the classification of the legal relationship that one of the parties records a debt or in which currency the parties are obliged to repay their debts. As regards the foreign currency loan as a special type of loan agreement, exclusively denominated currency, i.e. the currency in which the parties specified the cash debt in the concluded loan agreement, is of legal significance. If the loan amount is determined in a currency other than the forint, which can be clearly identified from the contract, the foreign currency legal relationship has been validly established regardless of how the parties record the cash debt, and in which currency – possibly in a different currency – parties are required to repay their thus determined debt.

After October 2008, i.e. the outbreak of the crisis, several legal disputes arose in connection with foreign currency loan agreements leading progressively to mass litigation. However, in the period examined, the lawfulness of the legislative framework and the contractual practice developed based on this was not questioned regarding the fundamental issue of foreign currency lending. As regards the fundamental issue, however, we should have a brief

[9] See: Paragraph (4) of Section 261 of Ptk 195 effective between 14 August 2010 and 31 December 2010, Section 200/A of the old Hpt effective as of 27 November 2010, and Item 1. of Paragraph (1) of Section 1 of the Act LXXV of 2011 and Paragraph (4) of Section 13 of the Act XL of 2014, respectively.

[10] Paragraph (2) of Section 13 of the Act XL of 2014, Item d. of Paragraph (1) of Section 2 of the Act LXXV of 2011

look also at the period after 2010, because as the crisis deepened and the interest conflicts erupted, the lawfulness and validity of even the contract type became disputed.[11]

The order of magnitude of a society level problem is well indicated by the fact that finally at the end of 2013, the Civil Department of the Curia had to pass a decision as uniformity panel,[12] inter alia on the following matters:

a) What is the content of foreign currency based loans (a foreign currency based loan is a foreign currency loan or a forint loan)?
b) Are contracts concluded based on the construction of foreign currency based loans valid or invalid contracts (i.e. do they infringe legislation, are they manifestly in breach of accepted principles of good ethics, are they unfair contracts, are they usurious contracts, or do they feature defective intention, meaning are they misrepresented contracts, or contracts concluded as a consequence of deception or mistake?

The answers formulated by the Curia in its uniformity decision were already evident for most of the legal practitioners, but disappointing for those involved as debtors. Namely, the Curia made it clear that the foreign currency based loan agreement in itself, due to the fact that the debtor must run the exchange rate risk as the consideration for the more favourable interest rate, is not in breach of law nor is manifestly in breach of accepted principles of good practice, is not a usurious contract, is not aimed at impossible service and is also not a misrepresented contract. Thus, it was not the Curia who disputed the validity of the contractual basic construction.

3. Problem definition

3. 1. The perception of foreign currency lending

An important question in the history of foreign currency lending is: what actually was the problem? At the level of common experience two totally opposing but clear answers can be given:

(i) there was no problem with foreign currency lending during the period between 2004 and 2008. In fact, in the period after the accession to the European Union[13] full of hope, it meant

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[11] An example for this is inter alia Péter Róna's presentation at a conference on 1 February 2013: *"Foreign currency loan is not a loan, because the loan means lending a specified amount which the debtor must repay with specified conditions. On the contrary, in the case of foreign currency loans we do not know the amount to be repaid because this amount is calculated on the basis of a foreign exchange rate. For this reason, the borrower does not know the extent of the obligation he has undertaken, neither for the entire term nor meanwhile during the repayment of the loan."* See: https://hvg.hu/gazdasag/20130201_Rona_Peter_A_devizahitelezes_miatt_az_all - time of last downloading: 09 October 2018
or the interview given by Viktor Orbán prime minister in Kossuth Radio on 5 July 2013: *"A fundamental legal question is, for which as a national I'm also expecting an answer, whether foreign currency loans are defective products."* https://www.penzcentrum.hu/hitel/orban-hibas-termek-e-a-devizahitel.1036995.html - time of last downloading: 09 October 2018

[12] Uniformity decision No. 6/2013 of the Curia of 6 December 2013 of certain questions of principle that arose in the legal proceedings related to foreign currency based loan agreements

[13] The Accession Treaty was promulgated in Hungary with Act XXX of 2004, which entered into force on 1 May 2004.

a “smart solution” by means of which housing and consumption could be increased – with low interest rates – in the wider population which brought the hope of welfare within reach. Additionally, lenders were absolutely satisfied, as both the rate of portfolio increased and the profit content of the foreign currency lending ensured all-important growth for them.

(ii) In the period between 2008 and 2010, foreign currency lending had become a synonym for the loan operation representing societal trauma and causing severe crisis. The unexpected exchange rate increase and its sustained continuation that started in October 2008, as well as the massive,[14] and in many cases, unbearable retail debt increase resulting from it provided a scapegoat for banks offering foreign currency based loans in the wider population. Besides this, the banking system has thus far suffered unimaginable losses, and by 2010 the situation even threatened financial stability.[15]

Approaching the issue from a professional point of view, it is evident that quite a diverse and complex answer can be given, affecting a number of branches, which has already been revealed in a diverse manner by studies elaborated so far. We are in a difficult situation even if looking for an answer to the question as a legal professional, because in legal disputes associated with foreign currency lending the partial or full invalidity of such contracts has been raised in multiple aspects. The “foreign currency lawsuits” that presented in high number and diverse reasons for invalidity, the uniformity decisions surrounding these lawsuits and besides these, the legislature’s number of measures to amend acts all indicate that several legal problems could be identified here.

In my view, however, in examining the legal features of this type of contract there is a single underlying problem: exchange rate risk! This kind of risk is an inseparable element of this contract type, which fundamentally distinguishes it from other loan operations. The increase of indebtedness based on the exchange rate risk and the social dimensions thereof is the fundamental reason for, and at the same time, the explanation to the Hungarian credit crisis. And although during the period of the crisis a number of other legal issues emerged in connection with the foreign exchange lending – most importantly the unfairness of unilateral contract amendment –, these otherwise important issues, however, cannot be identified as the features of foreign exchange loans.[16]

The exchange rate risk, as a relevant element of foreign currency lending, should be examined in detail from two aspects:

- the legal nature of exchange rate risk, and
- from the point of view of the lender’s obligation to provide information on the exchange rate risk.

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[14] BALÁS – NAGY: opus cit 422. *“Currently millions of people have a foreign currency loan, out of which approximately 1 million have mortgage loans.”*

[15] BALÁS – NAGY: opus cit 416. *“From 2004, the extremely dynamic retail foreign currency lending tightened the efficiency of monetary policy, while the high ratio of foreign exchange portfolio that had been built up to that time has become the source of financial stability risks.”*

[16] The issue of differing exchange rates (so called spread) emerged as a special legal issue that can be linked with foreign currency loans. This however had insignificant importance in the development of the crisis and the injury to the interests caused, thus it cannot be deemed as an essential problem. The debate was closed with Section 3 of the uniformity decision No. 2/2014 of the Civil Department of the Curia, according to which: *“The application of a different exchange for the purposes of repayment of the loan (selling rate) to that used for the advancement of the loan (buying rate) is unfair because the financial institution does not provide any service directly for the consumer, therefore it is an unjustified cost for the consumer. These clauses are furthermore unfair because the economic reasons for their application are not clear, not intelligible and not transparent for the consumer.”*

3. 2. The legal nature of exchange rate risk

3.1.2. Antecedents

As a preliminary point, in order to recall the way of thinking typical of the period, the reasons that could explain undertaking such a new risk – which was essentially unknown for a wide range of borrowers – at the debtors' side[17] should be examined. It is important, however, to point out that a legal examination cannot give a full answer to the reasons of the emergence of risk appetite, it only can identify aspects fed into it.

An important circumstance for the debtors could have been – which can also be identified through legal regulation – the defining experience of borrowing in the period directly preceding the foreign exchange lending, i.e. forint-based housing lending with state interest subsidy. The 2000 to 2003 period of this programme represented such a "golden era", where the eligibility criteria for the subsidy allowed wider participation of households. In these years, due to the level of state subsidy, forint mortgage loans were available for all housing purposes – even for the purchase of occupied housing for investment purposes – with low interest rates. This program, which included two types of state interest rate subsidy[18], has significantly increased retail borrowing and made the prospect of growth a reality for many. The government decision that brought about the material reduction of subsidies at the end of 2003[19], which introduced a significant tightening both with respect to subsidised loan purposes and the level of subsidy, put an end to this process. However, the desire to take on low interest loans certainly did not vanish.

Another important circumstance, which can also be identified through analysing legislation, was the liberalization of foreign exchange administration, which occurred just two years before the actual commencement of foreign currency lending.[20] This move, as a symbol of

[17] There is no doubt that the motivations of the supply side, i.e. lenders, was at least as important in the foreign exchange lending coming to this dimension. We are, however, not addressing this aspect in this study, as that is fundamentally not reasons of legal nature.

[18] The two types of State aid were, on the one hand, the mortgage bonds interest subsidy introduced with the amendment of Council of Ministers Decree No. 106/1988 (XII. 26.) on housing aid, which entered into force on 1 February 2000; and on the other hand the supplementary interest subsidy. The interest rate subsidy linked to mortgage bonds could be provided by the credit institutions issuing mortgage bonds, while the supplementary interest subsidy could be provided by any credit institutions to the borrowing debtors. The gradual extension of the supplementary interest subsidy was realised through Government Decree No. 12/2001. (I. 31.), in force as of 12 February 2001 and as amended from time to time.

[19] Government Decree 221/2003. (XII. 12.) on the amendment of Decree No 12/2001 on State Aid for Housing entered into force on 22 December 2003.

[20] Item n) of Paragraph (1) of Section 6 of the Act XCIII of 2001 on the Abolition of Foreign Exchange Restrictions and on the Amendment of Certain Related Acts repealed Paragraph (3) of Section 231 of the 1959 Civil Code. According to the repealed rule of 1959 Civil Code: "*The legal regulations on foreign exchange shall determine the cases in which it is actually permitted to stipulate or make payment in foreign currency or gold.*" As a result of this amendment – after a long time –, debt could be lawfully denominated in foreign currency.

rapprochement with the European Union[21], has brought about an actual change in everyday life, which has created a promising yet unknown opportunity for all actors in the economy.[22]

The third reason to be mentioned is the initially realistic promise of the introduction of the euro, although it did not take a legal form, but was clearly present in public thinking. According to the unanimous statements of the Prime Minister, Minister of Finance and Central Bank Governor prior to the actual commencement of foreign currency lending in 2004:

"16 July 2003 – Hungary wishes to introduce the euro as of 1 January 2008 – Péter Medgyessy, Prime Minister, said on Wednesday. In order to achieve this goal, the Government would pursue a rigorous economic policy, with which the Governor of the Central Bank also agrees. The Prime Minister emphasised that the introduction of the euro is a national matter. As a single currency, the Hungarian euro will embody the economic results of Europe, its introduction will result in new jobs, low inflation, economic growth, it assumes the elimination of exchange costs and an increase in investments. According to Csaba László, Minister of Finance, the introduction of the euro will result in a massive cost reduction for companies and an expected increase in investment. By 15 August this year, the Government will submit the final pre-accession program to the EU, the so-called PEP, and by the end of September it will present the budget bill to Parliament. Hungary intends to join the ERM II exchange rate regime of the European Union as soon as possible in May 2004. Zsigmond Járai, President of the National Bank of Hungary, said that the central bank supports the introduction of the euro on 1 January 2008 and agrees that a rigorous economic policy should be pursued to achieve this goal."[23]

From this apparently solid starting point, by the middle of the period the promise of the introduction of the euro had become uncertain, but we still could count on it as a reality: *"21 September 2005 – it is feasible to introduce the euro in 2010 – said János Veres as a response to the announcement of Zsigmond Járai Central Bank Governor on the day before, stating that introduction of the euro in 2010 was impossible."*[24]

However, by mid-2008 it became clear that the introduction of the euro would not be a reality in the foreseeable future: *"Both the Government and the central bank renounced to set the date for the introduction of the euro this year. It is expected that the announcement of Hungary's target date for the introduction of the euro will be delayed to early 2009".*[25]

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[21] According to the preamble of Act XCIII of 2001: *"As a consequence of the establishment of the market economy, completing the convertibility of the forint, the Parliament, in order to prepare for the accession to the European Union, establishes a law on the abolition of foreign exchange restrictions and on the promotion of the free movement of capital."*

[22] *"The fact that the Hungarian population was particularly insensitive to this risk is partly due also to the fact that in past decades it did not even have the possibility to learn or discuss or experience exchange rate risk in a country with exchange controls."* See: Oral information of Zsigmond Járai In: Minutes of the meeting of the Sub-committee of the Parliamentary Committee on Constitutional Affairs, Justice and Procedures investigating to identify the causes of retail foreign currency indebtedness between 2002 and 2010 and to establish the possible responsibility of the government held on 3 November 2011, page 18. Available on the internet: https://www.parlament.hu/biz39/bizjkv39/AIB/A412/1111031.pdf

[23] https://hvg.hu/gazdasag/00000000004C9BA8 - time of last downloading: 07 October 2018

[24] http://www.origo.hu/gazdasag/hirek/hazaihirek/20050921veres.html - time of last downloading: 07 October 2018

[25] http://www.kisalfold.hu/belfold_hirek/elkepzeles_sincs_az_euro_bevezeteserol/2062028/ - time of last downloading: 07 October 2018

3.2.2. Determining exchange rate risk

As explained above, the essential feature of a foreign currency loan is that the parties do not specify the cash debt in the legal tender of the place where the contract is concluded, but in a different currency. In Hungarian modern foreign currency lending, predominantly Swiss franc, and to a lesser degree euro and Japanese yen were used as the so-called denominated currency.

The contractual practice showed a difference in what the parties chose for the paid currency – which does not significantly affect the foreign currency loan nature of the contract. According to generally accepted contractual practice, the paid currency was the forint for both parties (foreign currency based loan). Thus, the lender also fulfilled (disbursed) its obligation in forint and the debtor also repaid it in forint. However, as a rarer solution, we could also encounter a practice where the parties applied an enforcement clause effective in a foreign currency (foreign currency loan) for the debt settlement, i.e. they specified as paid currency not the forint but the same currency as the denominated currency. In both cases, however, it can be stated that if the borrower's income (eg salary) was generated in forint – which was obviously the situation in most cases – despite the contractual difference in the denominated and paid currencies, the exchange rate risk was borne by borrowers to the same extent.

In the case of foreign currency based loans, the forint amount required for foreign currency repayment was transferred by the debtor to the bank. However, the debtor of the foreign currency loan converted the forint amount required for – and equivalent to the – foreign currency repayment to the currency specified for the repayment and paid this foreign currency amount to the creditor as repayment. The direction and extent of exchange rate changes from time to time are objective circumstances which are independent of both parties involved in the loan agreement. The current exchange rate at each moment of the maturity shows the value of the paid currency in the denominated currency.

It is also important to emphasise, in relation to exchange rate risk, that it is not a condition of the foreign currency loan that the parties may define in the loan agreement. Thus, it is not part of the Annual Percentage Rate (APR) expressing the ratio of the total costs of the loan to the total loan amount. This essential feature of exchange rate risk was first defined by the legislature in the so-called APR decree[26] effective from 1 February 2005.

In practice as a general rule, in the case of foreign currency lending, both parties, i.e. the creditor bank and the borrowing debtor, were required to meet their respective payment obligations in forint, so they bore the exchange rate risk – to a significantly different degree but in theory in the same way. For both parties, this risk-taking was not based on a separate contractual clause in respect of their own debt, but was an obligatory result of determining the currency of the debt.

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[26] According to Paragraph (1) of Section 13 in effect between 1 January 2005 and 11 June 2010 of Government Decree 41/1997. (III. 5.) on the calculation and publication of the index on deposit interests, yield of securities and annual percentage rate: "*The Terms and Conditions, Public Disclosure, and Offering posted by the Financial Institution in its business premises shall include prominently the APR, with the addition that: a) the APR is determined by taking into account current conditions and current legislation and may change in the event of a change in the conditions, b) the value of the APR does not reflect the exchange rate risk of the loan; c) the value of the APR does not reflect the interest rate risk of the loan.*"

3.2.3. The debtor's exchange rate risk

The content of this risk is that the effect of the exchange rate fluctuation between the disbursement of the loan and its repayment in instalments over a typically long term is exclusively at the debtor's expense/benefit. The weight of this risk for the debtor is that the direction and extent of the exchange rate is unpredictable, thus inevitably creating a speculative situation, and in addition, this uncertainty persists throughout the entire term.

According to the approach regularly formulated regarding the debtor's exchange rate risk – still present in Hungarian judicial practice[27] – the creditor transferred the exchange rate risk to the debtor (imposed on the debtor) by means of the contractual terms applied by it. In my view, however, according to the correct interpretation it is not the creditor bank who transfers the exchange rate risk of the repayment to the debtor, since this risk has not even arose for it, but in the case of this type of credit transaction this risk is conceptually always borne by the debtor. *"Foreign currency debt necessarily entails exchange rate risk, i.e. the uncertainty about the amount of domestic currency required to settle foreign currency debt at the time of settlement (irrespective of whether the debt is paid in forint or in any foreign currency). The debtor of a foreign currency debt, unless his position is hedged in some way, inevitably exposes himself to this risk, due to the nature of the transaction. It is irrelevant from the point of view of the debtor's obligation or the legality of the transaction whether he has correctly or mistakenly predicted the future development of the exchange rate, and made overall a good choice or lost by opting for the currency of the debt".*[28]

Examining the contractual practice of foreign currency lending by Hungarian banks typical for the period covered by this study, it can be clearly established that there was no clause on transferring the credit risk of the loan repayment to the debtor. So there were no clauses in the model contract we reviewed[29], thus there was no clause which would have read as follows: *"The Parties agree that the exchange rate risk arising from the repayment of the foreign currency loan will be borne by the Debtor instead of the Lender."* Such a clause would obviously have been pointless and unnecessary, so it was not applied.

However, the question arises as to how the regulation regarding the debtor's exposure to this very important risk can then be caught in foreign currency loan contracts. The presence of this risk in contracts can only be shown indirectly from the following two aspects:

- in determining the denominated currency of the debt in foreign currency and
- among the rules on repayment obligations.

[27] Question 2 (fragment) of the decision No. 20030/2018/6 of the Buda Central District Court dated March 21, 2018, initiating the European Court of Justice's preliminary ruling procedure: *"Is it possible to consider fair, i.e. clear and understandable, in terms of economic consequences, the contractual term imposing the exchange risk on the consumer drafted on the basis of a statutory obligation to provide information that is necessarily formulated in general terms (as a general contract term applied by another professional contractor and not agreed upon individually) that does not explicitly include a notice that the exchange rate has no upper limit in the loan agreement …"* - http://hitelsikerek.hu/wp-content/uploads/2018/06/11.-EDE.pdf - last downloaded: 12 October 2018

[28] GÁRDOS –NAGY: opus cit 377.

[29] The contractual practice was analysed on the basis of the model contracts made available by CIB Bank Zrt., Erste Bank Hungary Zrt., K&H Bank Zrt., Raiffeisen Bank Zrt., Takarék Kereskedelmi Bank Zrt. (formerly known as FHB Bank Zrt.) as well as UniCredit Bank Zrt. In the case of provisions quoted literally from the model contracts, the name of the bank applying it is not indicated on their request.

Typical examples of contractual clauses using foreign currency as denominated currency are the following:

a) In the case of a foreign exchange based loan

The Bank provides to the Debtor(s) a loan of ………………… CHF, i.e. …………………… Swiss franc for secure financing of the Debtors, taking into account the Debtor(s)' request that for the purpose set out in Section I.2 of this contract, the Bank shall meet the financing needs for …………………… .forint, i.e. …………………. forint explicitly through CHF settlement."

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"The Parties agree that with the property (properties) (hereinafter: Property) collateral indicated in this section, the Bank shall grant Debtors the following Loan (hereinafter: the Loan) to meet the financing needs specified in the Application:

A) Amount of financing needs_ ……………. HUF, i.e. …………….. forint

B) Recording currency of the Loan: Swiss franc (CHF),

C) Loan Amount: ………… CHF, i.e. …………….. Swiss franc

D) Number of instalments: ……"

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b) In the case of foreign exchange loan

"1.1 The Bank shall, under the terms of this contract (censorship number: ………………., credit number: ……………………..), open a CHF / EUR, i.e. Swiss franc / euro credit line (Credit Line) and grant thereunder the Debtor – for the purpose of buying a home – a loan, and the Debtor is obliged to repay the loan and all its charges according to this contract.

1.2. The Debtor acknowledges that the maximum amount of the Loan available under the Credit Limit is the foreign currency counter value of the forint amount of the portion of the purchase price set out in Section 2 at the Bank's buying rate applicable to private individuals and valid on the day of loan disbursement, but not more than the Credit Limit.

1.3. If the foreign currency counter value of the portion of the purchase price according to Section 2 calculated in accordance with Section 1.2. is less than the Credit Line, the unused portion of the Credit Line will be cancelled on the day the loan is disbursed."

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c) In the case of a combined model contract

"2/a. Amount of financing needs for this loan:

…….. HUF, i.e. ………….. forint

(in the case of home purchase, maximum the last portion of the purchase price according to the purchase contract, in the case of loan refinancing the amount of the outstanding debt)

2/b. Loan Amount:

Alt. ….,- CHF, i.e. ……. Swiss franc.

Alt. …,- EUR, i.e ……. euro

Currency of disbursement: Alt: forint Alt: euro Alt: Swiss franc

(in the case of a home purchase, the disbursement must be made in the currency of the purchase contract)"

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The typical contractual provisions applied to the obligation to repay foreign currency debt were as follows:

a) In the case of foreign exchange based loan

“The Debtor is obliged to fulfil his payment obligations determined in the currency of the Loan by transferring their forint counter value to the Creditor's forint account number: ………… The Debtor shall pay the forint counter value of the payment obligation no later than on the due date of the debt, at the repayment rate specified by the Creditor and published in accordance with the Business Regulations, in a manner that the forint counter value is available on the above account at the latest on the due date. The Creditor shall convert the Debtor's payments on the date of crediting them to the above forint account, at the repayment rate of the relevant currency valid on that day and determined by the Creditor to the recording currency of the Loan, and shall credit it to the account intended to keep record of the Debtor's foreign currency repayments, and shall account it as repayment on the due date – in case of late payment on the day of the actual payment – in foreign currency.”

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b) In the case of foreign exchange loan

“The repayment of the loan and the payment of interests are made in the annuity instalments that include the repayment of principal and interest due, in the currency of the loan according to Section 1.1.”

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c) In the case of a combined model contract

"The payment of the loan and the currently effective interest rate in case of forint repayment shall be effected in such a way that the Bank shall debit the Bank Account with the amount of the forint counter value of the loan and interest on the due day of payment. In the case of repayment in foreign currency, the Bank shall debit the Foreign Currency Account with the amount of the loan and interest on the due date of payment.

In order to pay the loan and interest (the repayment instalment) – taking into account the exchange rate to be announced on the due date of the payment – the Debtor / Co-Debtor(s) is (are) obliged to arrange for the payment in a timely manner, at the latest until 2:00 pm. (two o’clock in the afternoon) on the due date of the payment.

In the case of forint repayment, the loan and the currently effective interest rate shall be converted into forint at the so-called cash foreign exchange selling type rate announced by the Bank on the day of actual payment.”

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On the basis of the examined model contracts, it is clear that the exchange rate risk arising from the repayment of the foreign currency loan was borne by the Debtor without any restriction, but the extent of this risk was not at all indifferent for the creditor. On the basis of the creditworthiness assessed and established by the creditor during the credit assessment, the bank also knew that the solvency of its client with income in forint was ensured only up to a certain exchange rate. Therefore, the possibility of converting to forint as a special risk management tool emerged in the contracting practice which was due to both parties. A good example of this is the following contractual clause:

"The Bank shall be entitled to convert the Debtor's Debt denominated in foreign currency on the accounting date of interest period, from which it shall notify the Debtor in writing 15 days prior to the expiry of the relevant interest period. After the conversion, the Bank shall keep the Debtor's entire Debt in forint. The conversion to forint shall be made by applying the buying exchange rate of the Swiss franc / forint determined by the Bank for retail clients on the accounting date of the interest period. The Debtor shall also be entitled to initiate the conversion of the Loan into forint at least 15 days prior to the accounting date of the relevant interest period. If the Bank approves such conversion, it shall take place under the conditions set out in this section, with the Debtor being obliged to pay the Bank the conversion fee specified in the List of Conditions at the latest on the day of conversion."

3.2.4. Exchange rate risk of the creditor

The content of the exchange rate risk borne by the creditor is that the exchange rate fluctuation during the period between the conclusion of the contract and the disbursement of the loan in forint falls on the creditor. This risk shows significantly different characteristics compared to the risk borne by the debtor and is characterized by the following:

a) Risk of the feasibility of the credit:

This risk arises from the fact that the realization of the typically specified credit goals (e.g. buying a home, loan refinancing) is a circumstance important also for the lender, which can significantly influence primarily the value of the mortgage based on real estate collateral. To achieve these credit goals, the debtor needs a specific forint amount, which cannot be precisely determined in the case of a foreign currency based loan, as it depends on the value of the exchange rate on the day of the disbursement and may as well be lower or higher than the desired amount. The following contractual provisions had been applied to manage these risks:

"The Parties agree that if, due to a change in the exchange rate between the time of the conclusion of this contract and the disbursement, the amount of the Credit Line is less than the foreign exchange counter value of portion of the purchase price according to Section 2 calculated at the Bank's buying rate applicable to private individuals and valid on the day of loan disbursement, the Bank may disburse the difference to the Debtor even beyond the amount of the Credit Line. The debtor in turn undertakes to repay also the loan amount above the Credit Line in accordance with the terms and conditions set out in this contract, furthermore to pay the agreed interest, handling fee and other fees, expenses and charges also for this amount. The debtor undertakes to sign the amendments to the contract limited to the changes necessary for the increase of the loan amount upon the Bank's written initiative within 10 days of the Bank's written request. The debtor acknowledges that a breach of this commitment constitutes a serious breach of contract."

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"In case of refinancing a loan with a credit institution, if the forint counter value of the present loan – due to the changes in the exchange rates announced by the Bank – does not provide sufficient coverage for the debt according to paragraph I/1., the Debtor / Co-Debtor (s) shall pay the Credit Institution the outstanding amount from their own resources at the same time as this loan is disbursed, and to prove the completion of such payment to the Bank in the manner and at the time specified in the seventh indent of paragraph II/8.1."

b) Risk to the sustainability of real estate coverage

This risk arises from the fact that banks could apply mortgages on real estates located in Hungary as a cover for foreign currency mortgage lending. The value of these properties and the repayment that they ultimately secured could be determined and interpreted in forint. Thus, although the extent of mortgages was determined in the currency corresponding to the denominated currency, the real estate collateral with a value independent of the exchange rate fluctuation of the forint was able to serve as cover only to a certain exchange rate level. The contractual clauses for managing such risk were the following:

"If due to a large change in the CHF/HUF exchange rate /a change of at least 5% / (taking into account also the potentially changed real estate market conditions), the value of the real estate provided as collateral no longer provides the Bank with adequate coverage, then the Debtor shall be obliged to provide the bank with sufficient additional collateral within 30 calendar days."

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"If the ratio of the counter value of the principal debt of the Debtor outstanding in foreign currency calculated at the forint exchange rate published by the Magyar Nemzeti Bank for the current currency of the Loan and the value of the collateral value specified in this Agreement exceeds at least by 10%, i.e. ten percentage points, during the term of the Loan.... %, i.e.… per cent, i.e.… per cent,[30] the Debtor shall be obliged to provide a first-rank mortgage on another property located in the territory of Hungary (providing additional collateral) and accepted by the Lender within 30 days, i.e. thirty calendar days from the Lender's first call by concluding a mortgage contract."

Based on the contractual practice presented, it is clear that foreign currency lending and the inseparable exchange rate risk can be clearly described from a legal point of view, its legal nature can be clearly defined. However, it is also evident from the practice of the period from 2004 to 2010 that although the parties tried to deal with the possible effects of exchange rate risk with a number of contractual clauses, it was not possible to eliminate its actual risk within the framework of loan agreements.

3. 3. Obligation to provide information

The legal assessment of the information provided on the exchange rate risk by creditors to debtors can be defined as the most important and most lengthy legal dispute.[31] This issue leads us to the fundamental question of foreign currency lending that arose (also) in Hungary: is it fair or unfair contractual practice to provide foreign currency loans at the debtor's exchange rate risk?

[30] The quotient of the coverage limit according to the approving loan decision and the collateral value of the collateral must be indicated.

[31] The issue was also addressed by the Consultative Board – set up by the President of the Curia and composed of representatives of judges of the Courts of Justice at different levels of the country dealing with such cases –, dealing with issues of invalidity in connection with foreign currency lending, inter alia at its meeting held on 10 October 2018. A memorandum of the meeting is available at: http://kuria.birosag.hu/sites/default/files/konz_testulet/sajtokozlemenyc-51.17_masolata_0.pdf – last downloaded: 13 October 2018

An essential requirement, also in terms of the valid conclusion of the loan agreements, is for the parties to be aware of the essential content of their contracts. In the case of foreign currency loans, this key requirement means that the parties must be aware of the fact and significance, as well as the possible consequences of the speculative element arising from exchange rate risk.

In the case of foreign currency loan agreements, as in the case of many other banking products, there is no balance of information between the parties. The creditor's knowledge of the nature of the exchange rate fluctuation and its possible consequences is much broader, so banks are required to provide information. The importance of the obligation to provide information is that the lack or omission of this obligation may – ultimately – lead to unfairness and, therefore, the invalidity of the contract concluded.

However, as we have seen above, the exchange rate risk borne by the debtor is a characteristic feature of the foreign currency loan, it is borne without any restriction by the debtor and it is not passed on by the creditor. A clause that fulfils the obligation to provide information is included in the contract, and thus appearing as a contractual provision, must be interpreted – on the basis of the established judicial practice that has also been confirmed by the Curia[32] – as a general contract term or a contract term individually not negotiated, whose unfairness can only be examined if its contents were not clear or understandable.[33]

3.3.1. Regulatory background of the obligation to provide information

In the course of reviewing the issue, we will recall the chronologically changing content of the relevant key statutory rules and the explanations thereto added during the legislation in the hopes that this method can bring us closer to the legal thinking of that period.

3.3.1.1. The Civil Code

To properly judge the legal obligation to provide information, we can define Article 205 (4) of the 1959 Civil Code as a basic provision.[34] According to this: *"Parties shall cooperate during the conclusion of a contract, and they shall respect each other's rightful interests. Parties shall inform each other regarding all essential circumstances in relation to the proposed contract before the contract is concluded."*

Special provisions for consumer contracts which later became decisive in importance –that tried to provide effective legal safeguards by the establishment of the standard of unfairness – were included in the 1959 Civil Code with Act XXXI of 2009, entering into force on 22 May 2009. The new standard paragraphs (4) and (5) of Section 209 of the Act read as follows:

" (4) A standard contractual term, or a term not individually negotiated in a consumer contract, shall also be regarded as unfair simply on the ground that it is not in plain intelligible language.

(5) The provisions concerning unfair contractual terms shall not be applicable to contractual terms that define the main subject matter of the contract or to those that determine the balance between performance and consideration, provided that those terms are in plain intelligible language."

According to the explanatory memorandum of the new provisions introduced into the 1959 Civil Code: *"Pursuant to Article 5 of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in*

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32 See Section 1 of PJE Resolution No. 2/2014 of the Curia

33 Article 4 (2) of Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts: *"Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplies in exchange, on the other, in so far as these terms are in plain intelligible language."*

34 The numbering of this provision, with unchanged content, has changed to (3) as of 1 March 2006.

consumer contracts: 'In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language. Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail.' The second quoted sentence corresponds in content to Article 207 (2) of the Civil Code. In relation to the first sentence, the Commission of the European Communities did not accept the Hungarian argument and the reference to the bill submitted to the Parliament on the new Civil Code and the provision in question, but called the Republic of Hungary in a so-called reasoned opinion dated 27 November 2008, to take the necessary measures to comply with the opinion within two months of receipt of the opinion. The amendment is intended to fulfil this obligation by incorporating the provision corresponding to the first sentence of the said Directive into the Civil Code, which is identical to the rule included in the Bill No. T/5949 [Article 5:81 (2) of the new Civil Code]. "

Thus, the internal legislative act transposing the directive came into force at a time when foreign currency lending was already in crisis. Therefore, the question of the applicability of this rule to contracts concluded before its entry into force became a serious issue in subsequent legal disputes. As a conclusion to the debate, the Curia ruled that these rules were applicable to the entire period of foreign currency lending.[35]

Due to the delay in the implementation of the referenced EU directives in Hungary, it may not be too exaggerated to conclude that the adoption of the principles, and most importantly the practice of Union-level consumer protection legislation has been delayed not only at the level of legislation but also at the level of the application of law. Consumer protection thinking of the period of foreign currency lending between 2004 and 2008 crucial in terms of the establishment of portfolios could not be framed by EU standard, but slowly developing Hungarian lending culture.

It is important to emphasize that civil law concepts essential in the legal assessment, i.e. the content requirement behind the "clear" and "understandable" information, can only be formulated with interpretation for the practice. In the pre-crisis period, these concepts – based on past experiences and public thinking characterised by optimistic catching-up expectations – meant something different in the everyday life of credit and were not backed by a mature legal interpretation supported by court judgements, which could have qualified their content. After the crisis, the expectations associated with these concepts have changed dramatically to the detriment of banks – obviously, in close connection with the search for those responsible and by using the existing information asymmetry as a reference. In reality, however, neither the banks considered as professional players in the market, nor the regulatory and supervisory authorities expected the dramatical exchange rate change.[36]

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35 See justification to Section 1 of PJE Decision No 2/2014 of the Curia: *"The fact whether the provision of the given contract on exchange rate risk is clear or understandable can be examined despite the fact that the vast majority of foreign currency based consumer loan contracts was concluded before amending the Civil Code with Act XXXI of 2009. With the referenced amendment in force since 22 May 2009, the provisions of the Association Agreement promulgated by Act I of 1994 and of the Directive already applicable also in Hungary through the accession to the European Union at the time of the conclusion of the contract were transposed."*

36 *"According to the information provided by the Hungarian Financial Supervisory Authority to the Curia on 31 May 2013, during the period between 2001 and 2008, financial institutions could not foresee either the extent nor the direction of future exchange rate changes. During this period, the Stability Reports of the National Bank of Hungary did not indicate significant exchange rate fluctuations."* - citation from Section III/3 of the Curia's 6/2013. uniformity decision.

3.3.1.2. The Act on Credit Institutions and Financial Enterprises

Special regulation of financial services during the period under examination was included in Act CXII of 1996. (hereinafter referred to as: CIFE). Article 203 of the CIFE initially set out the relevant information requirements as follows:

"(1) A financial institution shall unambiguously and clearly inform its present and future customers on the conditions of using the services provided by the financial institution as well as on any amendments of these conditions.

(2) A financial institution shall post the information described in Subsection (1) at an easily accessible place in the customer area of its premises, and shall make it available to customers free of charge when requested. Furthermore, where services are also provided in electronic commerce, the aforementioned information shall be made available to customers continuously by way of electronic communications in easily accessible format."

The first CIFE amendment related to the information provided to customers came into force on 10 July 2004[37] with the insertion of two new paragraphs:

"(5) Prior to entering into a contract, the financial institutions is obliged to inform clients if some law other than Hungarian law is to be used for settling legal disputes in connection with the contract or if Hungarian courts are not vested with exclusive jurisdiction.

(6) Unless otherwise agreed, credit institutions shall supply the information referred to in Subsections (1)–(5) in the Hungarian language."

According to the explanatory memorandum to this provision: "The law supplements and clarifies consumer protection regulations. It clarifies that customer information should be provided primarily in Hungarian, ..."

The next amendment of the relevant provisions of CIFE was amended[38] with effect on 1 January 2005. This amendment already brought about a targeted regulation explicitly for foreign currency lending, adding two additional paragraphs to Article 203 on information:

"(6) In the case of loan contracts with retail customers for granting foreign currency loans and that involves a right to purchase on a real property, the financial institution shall expressly specify in the contract the risks to which the client is exposed, and the client shall verify acknowledgement by his signature.

(7) The risk disclosure statement specified in Paragraph (6) shall include

a) in the case of a contract for granting foreign currency loan, the description of the exchange rate risk and its effect on the instalment,

b) in the case of a contract including a right to purchase on a real property, the manner and consequences of exercising the right to purchase, the manner of establishing the purchase price, of notifying the client and of the settlement by the financial institution, as well as the fact whether or not a grace period is granted to the client, during which the client may sell the property, and if so, the term of such grace period."

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[37] §17 of Act XLVIII of 2004

[38] §30 of Act LXXXIV of 2004

The reasons for this change were: "The amendment to the consumer protection provisions aims to provide better and more thorough information to customers. Since the beginning of 2004, the portfolio of foreign currency loans has dynamically expanded due to lower interest rates compared to forint loans. At the same time, in the case of changes to the exchange rate, the foreign currency loan also entails significant risks, the repayment instalments may increase, which should be brought to the attention of consumers in a separate risk disclosure statement."[39]

The last amendment[40] affecting the period under examination, effective from 1 September 2008 and defining customer information already as customer protection, has also tightened foreign currency lending. This amendment also set content requirements for the risk disclosure statement as follows:

"Customer protection"

"§ 203 (4) In the case of loan contracts with clients qualifying as consumers for granting foreign currency loan and that involves a right to purchase on a real property, the financial institution shall expressly specify in the contract the risks to which the client is exposed, and the client shall verify acknowledgement by his signature.

(5) The risk disclosure statement specified in Paragraph (4) shall include

a) in the case of a contract for granting foreign currency loan, the description of the exchange rate risk and its effect on the instalment,

b) in the case of a contract including a right to purchase on a real property, the manner and consequences of exercising the right to purchase, the manner of establishing the purchase price, of notifying the client and of the settlement by the financial institution, as well as the fact whether or not a grace period is granted to the client, during which the client may sell the property, and if so, the term of such grace period."

The related explanatory memorandum did not give specific reasoning to the provisions cited.

From the above changes in the rules of the CIFE, we can observe the constantly tightening regulatory requirements. However, the law laid down content requirements only on the verge of the crisis (from 1 September 2008) with the creditor's information on the exchange rate risk – that is, the risk disclosure statement. The banking practice mapping these regulatory changes into the contractual practice of foreign currency lending could then have assumed, with good reason, that standard of information applied following the entry into force of the individual amendments ensures the requirement of legal operation for them. However, legal interpretation in the post-crisis mass litigation has set the regulation of Directive 93/13/EEC – published in the Civil Code – as the same standard for banks for the entire period by assigning to it the content requirements according to post-crisis thinking.

3.3.2. Consumer perception

For the correct legal assessment of the obligation to provide information in foreign currency lending, the requirements for the consumer as a party entitled to protection must also be defined as an important

[39] Reasoning for § 30 of Act LXXXIV of 2004 on the Amendment of Certain Financial Laws to Supplementary Supervision of Financial Conglomerates.

[40] Paragraphs (4) and (5) of Section 35 of Act XLVII of 2008

circumstance. These requirements can be based on the legal definition of the "consumer", the specific feature of which is, however, that it is filled with content collectively by the legislature and the law enforcement party. *"The appropriate level of protection is thus determined by normative-generalisation modelling on the part of both the legislature and the law enforcement party. It is fortunate – but there are only a few examples of this, and especially in EU legislation – when the legislature itself defines in the explanation to the law the consumer profile which the law enforcement party can start from in practice. It is more typical that the law enforcement party fills the consumer definition with content without giving the regulator specific instructions on which consumer model to choose when applying the legal norm. However, this definition has been filled with real content by the Court of Justice of the European Union by elaborating a system of expectations for defining the level of protection due to such a person."*[41]

The definition of "consumer" applicable for financial services – thus for foreign currency lending – was introduced into CIFE by the Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices against Consumers effective as of 1 September 2008.[42] This is essentially identical to the definition in Directive 93/13/EEC.[43] However, following this step that can be deemed a starting point, although the European Court of Justice's jurisprudence[44] has already tried to fill this definition with content in the previous period, the interpretation of the law applicable to foreign currency lending was not available until 2010. A new interpretation of the law emerged only in the period well after the crisis in the case law of both the Court of Justice of the European Union[45] and the Curia[46].

On the basis of the above, it can be concluded that although Directive 93/13/EEC, thus its definition, also functioned as a valid legal norm during the period in question neither the Hungarian legal system nor the judicial practice destined for developing this perfected the level of protection due to consumers, which could have served as a clear and unambiguous benchmark for credit institutions providing foreign currency loans. Thus, unfortunately, the consumer protection standard of the expected information obligation related to exchange rate risk crystallized not during the period of concluding foreign currency loan contracts but afterwards.

It is also worth examining how retail borrowers qualified subsequently as consumers could be characterized based on the CIFE definition during the period of raising foreign currency loans. The importance of this is consumer protection itself is a requirement for consumers to have a general level of awareness, be reasonably observant and circumspect. As opposed to this, the financial knowledge of foreign debt borrowers was extremely low: *"The familiarity with terms important for taking up foreign currency loans (currency, exchange rate, APR) is low. Interviewees have indicated that the level of their knowledge regarding borrowing is weak / moderate. 40% of young adults with independent income*

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41 Rita SIK-SIMON: *Fogyasztókép és szabályozás. (Consumer profile and regulation)* MTA Law Working Papers, vol. 2016/2. 2.

42 See Annex III, Part III. Section 4 of CIFE: *"Consumer: a natural person acting for purposes other than his or her self-employed activity and economic activity."*

43 Article 4 (2) b) of Directive 93/13/EEC: *"consumer: any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession;"*

44 *"A milestone in the current case law of the European Court of Justice is the Gut-Springenheide case of 1998, in which the Court 'set in stone' the applicable average consumer model. The decision is based on the 'reasonably well-informed, reasonably observant and circumspect average consumer', where the word 'average' refers to the level of information, attention and intelligence."* SIK-SIMON: opus cit 13.

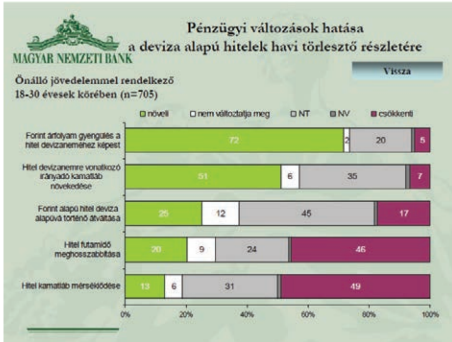
45 See Judgement of the European Court of Justice, No. C-26/13 (Kásler-case)

46 See section 1 of the Curia's 2/2014. uniformity decision

- *are not aware of the existence of the Central Credit Information System (CCIS) (KHR, formerly BAR)*
- *35% of them are unable to distinguish the main features of forint and foreign currency based loans,*
- *at least a quarter of them are unable to judge or judge incorrectly the impact of changes in financial conditions on the repayment instalment of foreign currency based loans"*[47]

Tájékozódás a hitelkonstrukció részleteiről és költségeiről	Gathering information about the details and costs of the credit construction
18–30 éves hitelfelvevők körében (n=335)	Among 18–30 year old borrowers (n = 335)
Vissza	Back
Viszonylag alaposan tájékozódott az egyes konstrukciók részleteit és díjait illetően	Was relatively well informed about the details and costs of the individual constructions
Apró részletekre kiterjedően áttanulmányozta a bankok ajánlatait	Studied bank offerings in details
Csak a hasonló termékek legfontosabb jellemzőinek nézett utána	Only checked the most important features of similar products
Nem nézett utána, mert a bankok által kínált termékek hasonlóak	Did not check, because the products offered by the banks were similar
Nem tudja/Nem maga intézte	Does not know/Did not arrange for it personally
Nem válaszolt	Did not answer

[47] See: Andrea Máger Deputy Director of the MNB on 23 May 2007, page 9 of the presentation titled *Increasing Retail Exposure - Low Financial Knowledge - Lessons from a Research* held at the Retail Finance Conference. Available on the internet: https://www.mnb.hu/letoltes/20070522-23-mager-andrea-1.pdf



Pénzügyi változások hatása a deviza alapú hitelek havi törlesztő részletére	Impact of financial changes on monthly repayment instalments of FX-based loans
Önálló jövedelemmel rendelkező 18–30 évesek körében (n=705)	Among 18–30 year olds with independent income (n=705)
Növeli	Increase
Nem változtatja meg	No change
Nem tudja	Does not know
Nem válaszolt	Did not answer
Csökkenti	Decrease
Forint árfolyam gyengülés a hitel devizaneméhez képest	Forint exchange rate weakening compared to the currency of the loan
Hitel devizanemére vonatkozó irányadó kamatláb növekedése	Increase in the reference interest rate of the currency of the loan
Forint alapú hitel deviza alapúvá történő átváltása	Conversion of forint based loan to foreign currency based loan
Hitel futamidő meghosszabbítása	Loan maturity extension
Hitel kamatláb mérséklődése	Loan interest rate decrease

Source: MNB, 2007

3.3.3. Partial summary

In this chapter we attempted to identify the core problem of foreign currency lending, the exchange rate risk and to describe the related legally relevant elements. On the basis of the facts and circumstances taken into account and their legal aspects, as well as everyday experiences, we can state that although the foreign currency lending crisis has generated massive disputes between borrowers and creditors, which made key issues widely disputed in legal terms, the real cause of the problem was not the unlawful contractual practice of the creditors, the deliberate or negligent misinformation of the borrowers.

We agree with the following view from the literature: *"We believe that the majority of foreign currency debtors were aware of the fact of the exchange rate risk, knowing that future instalments* *would be subject to unexpected exchange rate movements. They, however, expected that the extent of exchange rate fluctuations would be manageable, could develop even favourably, moreover, would be eliminated within the foreseeable future, by joining the euro zone. Obviously, neither the lay borrowers, nor the financial experts have calculated with the still continuing weakening of the exchange rate, the deterioration of Hungary's credit risk rating and the borrowing conditions. In addition, no one expected that Hungary's overall economic performance, investment and unemployment rates would be even worse than other countries in the region. The claim that debtors were deceived by the banks is therefore not true; the truth is that the circumstances evolved in a much less favourable way than the general expectations at the time of contracting".*[48]

4. Solutions to the problem

4. 1. Predictability of exchange rate fluctuations

The key issue in dealing with the problem of foreign currency lending is – now we know – the correct assessment of the exchange rate risk that inevitably accompanies it, and the limitation of the effects of these risks so that they do not cause a crisis of social scale and threaten financial stability. Therefore, a really effective tool against the foreign currency lending crisis would have been to prevent it and not to deal with a problem that had already arisen.

However, the risks of foreign currency lending in Hungary could not be properly assessed by professionally demanding studies either. Such is the so-called Várhegyi Committee report. The committee, acting as a proposing entity on the basis of a government decision[49], was tasked with reviewing the financial services and auxiliary financial services provided by financial institutions to the general public, in terms of effective competition and consumer protection, and to make proposals for the necessary government actions and the possible revision of relevant legislation. In its report drawn up by the end of December 2006, the Committee took stock of the key problems of the banking system identified then and issued a total of 17 recommendations. The most important proposals concerning retail lending were:

- positive list of debtors – obligatory for all financial service providers and all borrowers to develop responsible creditor behaviour and increase consumer safety;
- the pricing of credit institutions' products and services should be sufficiently transparent – clarification of the rules on individual customer information;
- re-regulation of unilateral contract modifications related to interest or fee components;
- creating a code of conduct.

Thus, it can be seen that the main findings of the report of the Committee of Experts did not identify a consumer protection problem related to exchange rate risk. In the report, the only statement related to foreign currency lending can be found among the proposals for further research: *"As a result of the increase of foreign currency lending, forint interest*

48 GÁRDOS – NAGY: opus cit 378.

49 Established by the Government Resolution No. 1097/2006 (X. 5.) on the establishment of a Committee of Experts on Retail Financial Services which also defined its tasks.

rates reflect to a lesser degree the Hungarian banking market conditions, and more structured analyses would be needed, which would take into account this new factor."[50]

Further exploring the professional thinking of that time, as a typical example we can cite that the demanding mortgage crisis analysis published on the eve of the Hungarian crisis, in May 2008, also contained an optimistic conclusion that *"risk-based competition in Hungary generated a strong increase in credit supply, maintaining the consumption ensured an adequate credit demand, but the over-indebtedness of the population is still manageable, there are no signs of mortgage crisis."*[51]

Although the above examples are only indicative, both the personal experiences of the participants of the era and the subsequent thorough evaluations confirm the important finding that neither the participants of the banking system, nor the regulatory and supervisory authorities, nor the most initiated experts expected the depreciation of the forint to an extent which eventually took place on a permanent basis from October 2008 onwards.[52]

The lack of prognosis had a decisive influence on the timing of the measures that could be taken to prevent the problem, since inevitably all measures could trigger a delayed effect, that is, were not sutable for prevention, but only post-treatment.

4. 2. Self-regulation

The whole period of foreign currency lending in Hungary was accompanied by an idea which was rooted in the legal thinking of the European Union at that time, that institutional operators of the financial markets are able to strengthen the consumer-friendly nature of market processes with regulation established by themselves and adhered to voluntarily but consistently. The first EU source of law on this idea – evolved before Hungary's accession to the EU, so it did not even have an official Hungarian translation – was the Commission Recommendation 2001/193/EC. This recommendation considered the voluntary accession to the "*Voluntary Code of Conduct on pre-contractual information for home loans*" as a desirable development direction for financial institutions.

The Várhegyi Committee was the first to make a concrete proposal for the creation and introduction of a "code of conduct" as a form of self-regulation of financial services in Hungary.[53] In the explanatory memorandum to the Várhegyi Committee's recommendation, it also stated why it considered as justified at improvement, by means of voluntary rules instead of statutory rules, of the consumer-friendly character of financial services: "*Credit institutions' behaviours and procedures developed in a self-regulatory manner could provide*

[50] See Report of the Expert Committee on Retail Financial Services - "9. Proposals for further research", subsection 6 – page 15

[51] Júlia KIRÁLY – Márton NAGY: *Jelzálogpiacok válságban: kockázatalapú verseny és tanulságok.* (Mortgage markets in crisis: risk-based competition and lessons learned) Hitelintézeti Szemle, 2008. Vol. 5. 481.

[52] See Section III/3 of the Curia's 6/2013. uniformity decision

[53] *"The Commission considers that the Banks' behaviours and procedures developed in a self-regulatory manner can provide a more effective solution to many problems than statutory obligations. The Commission recommends that professional associations of credit institutions and financial undertakings to establish a code of conduct applicable to all their member organizations offering solutions to address consumer problems."* See Report of the Expert Committee on Retail Financial Services - "1. Executive report", subsection 15 – page 4

a more effective solution to many of the previously discussed issues than statutory obligations. One of the reasons for this is that financial institutions are more familiar with customer related problems than regulatory authorities, only their short-term interests hinder their search for solutions that are beneficial for consumers. Another advantage of self-regulatory behaviour is that they can better promote compliance than external law."

As noted above, the report of the Várhegyi-Commission did not identify excessive retail exchange rate risk and did not propose any consumer protection measures in connection with such. Thus, it identified the purpose of self-regulation to regulate primarily the unilateral contract amendment, which was the subject of the most criticism at the time, and which subsequently dominated legal disputes for a long time.

The development of the importance of self-regulation in the banking sector is well illustrated by the fact that with entering into force of Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices on 29 June 2008 defined the concept of the Code of Conduct at the level of law[54] and assigned separate rules of responsibility to this regulatory instrument[55] and supervisory authority powers to monitor compliance.[56]

By the beginning of 2009, the first experiences of the exchange rate crisis that had already taken place did not change the stakeholders' belief that self-regulation could offer an appropriate solution to the increasingly serious problems. As a result of this process – in which the clear expectation of both the regulator and the supervisory authorities could be identified –, the *Principles of Fair Conduct by Financial Organizations Engaged in Retail Lending* was drafted with the participation of the Hungarian Banking Association and dated September 2009. The significance of a document of great importance for the credit life of that time, to which a total of 276 financial institutions joined according to the data published by the MNB[57], is the fact that its entry into force has been subjected by the signatories to the amendment of law with harmonised content, to the new Article 203 (6) of the CIFE[58] that entered into force on 1 January 2010. Among the signatories of the Code of Conduct was also the Chairman of the Supervisory Board representing the State Financial Supervisory Authority in charge of monitoring compliance with the Code.

The most important purpose and significance of this Code of Conduct was to set limits for the unilateral contract modifications of creditors. In addition, it also regulated a number of other issues, including those specifically dealing with retail foreign currency lending, as follows:

- *"To undertake upon the conclusion of the contract to make it possible for the customer to repay the foreign exchange loan in a lump sum in foreign currency."*[59]

54 See Article 2 i) of Act XLVII of 2008

55 See Article 9 (4) of Act XLVII of 2008

56 See Article 10 (2) of Act XLVII of 2008, and from 1 January 2010 Article 10 (6)

57 See https://www.mnb.hu/letoltes/alairok-1301129.xlsx

58 *"The financial institution shall inform the client at the latest before the conclusion of the contract, but in all cases in good time before the commencement of the provision of the service, in a clear and unambiguous manner, if it has subjected itself to the Code of Conduct, as defined in Article 2 i) of Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices in relation to its activities covered by the contract to be concluded, providing at the same time free access to the Code of Conduct."*

59 Code of Conduct Section II/s.

- *"To ensure transparency, the effective exchange rates applied for the disbursement and repayment of foreign-currency based loans and the differences from the central parity rate of the National Bank of Hungary (MNB) are to be made public.*[60]
- *To allow the loan refinancing and the lump sum redemption of foreign currency based loans in foreign currency in addition to the possibility of their conversion to HUF upon request of the customer."*[61]

The perception of the serious problem of foreign currency lending is obviously reflected in these voluntary rules set for foreign currency lending, but it was – understandably – inappropriate to deal with the social scale conflict created by the exchange rate collapse.

In the context of self-regulation as one of the possible problem-solving tools, it should also be mentioned that the Code of Conduct was later seen neither by the judicial practice[62] nor the legislature[63] as an instrument that can be suitable to resolving subsequent legal disputes.

Based on all these findings, we can consider the following statement to be valid: *"On the basis of the consequences, however, we can see that retail foreign currency lending in Hungary can be at the same time considered as a case study regarding the fact that retail lending can lead to a systemic risk level failure if market self-regulation does not work"*.[64]

4. 3. Supervisory regulation

Banking operation and, in particular, professional lending activity due to its high riskiness justifies both the market entry and operation to be subjected to state control. This important control function was provided by the Hungarian Financial Supervisory Authority (HFSA) for the entire period covered by the study, the operation of which was initially governed by provisions of Act CXXIV of 1999. Although between 1991 and 1996 the Law on Legislation recognized the "Banking supervisory provision" as a mandatory legal norm,[65] however, in the period under examination, the HFSA was already defined as a law enforcement institution, within the operation of which creating norms was not compatible with the tasks assigned to it. This type of instrument was first defined by the amendment of the Act which came into force on 6 May 2004,[66] through the rearrangement of

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60 Code of Conduct III /f. point

61 Code of Conduct IV/e. point

62 "According to Section IV/5 of the Summary Opinion of the case law analysing group set up for "The assessment of unfairness of unilateral contract modifications in general terms and conditions applied by financial institutions in a consumer loan contract": *"The Code of Conduct adopted by financial institutions is not a law; the court may review the nullity of the conditions allowing for the unilateral contract modification contained therein."*

63 The new provisions introduced by Article 3 (1) of Act XCVI of 2010 as 210/A of CIFE – with effect from 27 November 2010 –, overwrote the most important provisions of the Code of Conduct on unilateral contract modifications.

64 András BETHLENDI: *Egy rossz termékfejlesztésből rendszerszintű piaci kudarc. (Systemic market failure from a bad product development.) A hazai lakossági devizajelzáloghitelezés. (Domestic retail currency mortgage lending.)* Hitelintézeti Szemle, 2015. Vol. 1. 7.

65 Act XI of 1987 on Legislation, 51/ B. § *"In agreement with the Minister of Justice and the Banking Supervisory Board, the Chairman of the State Banking Supervision may issue requirements mandatory for financial institutions as a banking supervision provision within the scope specified in a separate act. The banking supervision regulation shall be published in the Financial Bulletin."*

66 Act XXII of 2004 on Amendments to Certain Acts Concerning the Protection of Investors and Depositors

the function of the Supervisory Board. At that time, the institution of "recommendation" emerged, which according to the statutory definition "*... has no binding force for organizations, persons subject to the law, it is intended to increase the predictability of the application of law*".[67]

The role and function of the recommendation as the only regulatory instrument available to the HFSA can be defined as follows:

– *"Provides a standard for financial organizations, indicating the HFSA's expectations regarding the enforcement of legislation*
– *To show the synergy arising from the knowledge of the HFSA and the financial organizations*
– *Can serve as the basis and source of the regulations of financial institutions"*[68]

Act CXXXV of 2007 re-regulating the operation of the HFSA from 1 December 2007 did not bring about any changes regarding this.

The supervisory recommendation as a market-shaping tool was also applied on the verge of the currency crisis. On 15 February 2008, the MNB and the President of the HFSA issued a joint recommendation on "Systemic risks of foreign currency lending and institutional and consumer protection requirements related to the prudential assessment and management of these risks, with particular regard to Japanese yen-based lending". This professional recommendation, elaborated in detail, laid down expectations regarding (i) the prudent rating of customers, (ii) the application of appropriate risk management systems, (iii) the responsible lending practices for consumer protection, and (iv) the rules of interest for agency sales. The main findings of the recommendation were the following:

- *"One of the major problems associated with yen-based products is that customers typically do not fully understand their features and the associated risks."*
- *"Before concluding a contract, the financial institution is obliged to illustrate to the client how, in the event of a 20% fluctuation in the exchange rate and a 1% interest rate change the repayment instalment and its ratio to income may increase."*
- *"A fundamental objective is to ensure that agents establish and use systems of interest and control that ensure the quality of the loans they mediate."*
- *Finally, the summary of the recommendation stated: "Competition poses a risk that credit institutions will build up excessive credit risk exposure under the pressure for growth, thereby increasing systemic risks and threatening financial stability. In adhering to the recommendation, however, it can be prevented that the long-term costs of the risk increases from new constructions outweigh the short term market benefits."* [69]

[67] Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority, Article 9/C. (1) c)

[68] See Dr. Éva Istvánovics, Directorate of Market Surveillance, Managing Director, Presentation at the Retail Finance Conference on 23 May 2007 on the *Recommendations of the HFSA Supervisory Board*, page 5. Available on the internet: https://www.mnb.hu/letoltes/20070522-23-istvanovics-eva-1.pdf

[69] See: Joint Recommendation of 15 February 2008 of the President of the Magyar Nemzeti Bank and the Chairman of the Supervisory Board of the Hungarian Financial Supervisory Authority, page 4

The recommendation, in addition to showing a sense of responsibility driven by the perception of growing systemic risks, also indicates that it puts the development of systemic risk into the future and not the present. On the other hand, it has not identified outstanding concerns regarding Swiss franc and euro used excessively in foreign currency lending, as it has identified in the case of Japanese yen. We now know that, at the time of the publication of the Recommendation, foreign currency loans accumulated so far have become a systemic risk as a result of the exchange rate shock.

Summarising the characteristics of the supervisory regulatory tools we can establish that we cannot consider the most powerful standard-setting instrument provided for the HFSA, the "Supervisory Recommendation", as a possible problem-solving instrument for foreign currency lending. The institution of the recommendation could not be suitable for the radical transformation of market processes and for the substantial limitation of the established course of lending and retail loan demand. Moreover, the other instruments available to the HFSA, not established by law but in the course if its own operation, which are even more of a guiding and non-enforceable instruments, such as management circulars, methodological guides, were completely out of the scope of effective regulatory tools.

4. 4. Legislation

When examining the role of legislative instruments in foreign currency lending, two periods should be distinguished:

- ***Period of prevention*** – this is the period from 2004 to 2008 and provides an opportunity to examine the measures taken to prevent the crisis,
- ***Period of crisis management*** – this is the period from 2009 to 2010, and the legislative events of this period can be interpreted as measures to manage the crisis that has already developed.

In discussing this chapter, it is important to emphasize that the numerous Hungarian sources of law and the wide-ranging legislative actions of the European Union could have influenced – directly or indirectly – the development of the Hungarian retail foreign currency lending from various directions and in a number of ways. Thus, without the necessity of completeness, we attempt to take into account the most important legislative actions to determine the legislative changes characteristic of the examined period.

4.4.1. Period of prevention (2004–2008)

As we have already established, the essential elements of foreign currency lending were the exchange rate risk and the creditors' obligation to provide information related to it. Analysing these two elements, as a regulatory objectives suitable for the management of risks and the prevention of excessive risk-taking, the following can be established:

A) Legal limitation of taking exchange rate risk

The legal possibility of the existence of exchange rate risk, i.e. the fact that not only forint but also other currencies can be validly used as denominated currency in loan transactions, was established by repealing Article 231 (2) of the 1959 Civil Code[70] as of 1 January 2002. This change in legislation was a general option and not specifically intended for retail lending. Thus, the amendment of the 1959 Civil Code did not have the task of establishing a framework for such risks that can be taken by the population. This issue must be sought obviously in the legislation applicable to the special market for financial services. However, we did not find either in the legislation or the lower-level sources of law any amendment during the period from the emergence of foreign currency lending and its development until 2008, i.e. until the crisis occurred, which would have required some limitation of this fundamental risk.

The lending practice of the period under examination was driven by the lending institutions' own internal risk-taking policy, which considered the so-called lending secured by collateral even with regard to foreign currency lending as a natural credit operation. In the course of this, it was not required to check the debtor's income, but only the market value of the property offered as collateral had to be determined. This could take place in many cases by taking the purchase price fixed in a sales contract as basis, and the upper limit for lending was based on that value. It is appropriate to define this phenomenon as a risk-based competition, which at that time did not encounter any legal constraint. As pointed out in the literature: *"Domestic banks are also trying to maintain their profitability by expanding their loan portfolio with increased risk taking. The strengthening of risk-based competition in the domestic market will mean primarily product innovation and the easing of lending conditions."*[71]

B) Regulation of the obligation to provide information

As a matter of consumer protection regulation, the prior customer information obligation of creditors has undergone several changes during this period. As a starting point, it is important to highlight that, initially, even the European Union's legislation considered the detailed content of this issue as an obligation imposed by the voluntary rules of creditors.[72]

By learning lessons from this regulatory methodology, a new EU directive[73] was drafted that not only laid down a legal obligation for creditor information[74], but also defined precisely its content.[75] However, this evolution of EU law still did not provide customer information – and hence a higher level of awareness – about mortgage lending, since the scope of the new directive did not apply to the type of transaction that provided the backbone of the foreign currency lending crisis.[76]

Although it goes beyond the 2008 period, I would like to mention here that when transposing the new directive into Hungarian law, the legislature defined precise content requirements for pre-mortgage

70 Article 6 (1) n) of Act CXXI of 2001 on the elimination of exchange restrictions and the amendment of certain related acts

71 KIRÁLY – NAGY: opus cit 468.

72 *See Recommendation 2001/193/EC of the European Parliament and of the Council on pre-contractual information to be given to consumers by lenders offering home loans.*

73 Directive 2008/48/EC on credit agreements for consumers and repealing Council Directive 87/102/EEC

74 See Article 5 (1) of the Directive

75 See Annex II of the Directive

76 See Article 2 (2) (a) of the Directive

lending information (the consumer credit act distinguishes general and personal information) in Act CLXII of 2009 (hereinafter referred to as: Consumer Credit Act) on consumer credit in response to the specific tensions of mortgage loans in Hungary, arisen primarily in the field of foreign currency lending.[77] Provisions of the Consumer Credit Act entered into force on 11 June 2010.

However, this statutory regulation, which can be said to be rather strict and imposes a very detailed information obligation, has not defined any requirements for the specific risk of foreign currency lending or for exchange rate risk. As for personal information, it only included the mandatory definition of the currency of the mortgage loan.[78] However, this was not of significance among the instruments of prevention and crisis management, since its entry into force in 2010 – after the crisis had already broken out – clearly ruled it out. However, it is noteworthy that the information requirements regarding exchange rate risk have not appeared – not even for the future – in this key legislation on consumer protection, despite the experience already made.

The legal obligation of the creditor to provide pre-contractual information has been de facto present in the provisions of both the 1959 Civil Code and the CIFE from the very outset. Here we recall what we have already explored only to an extent, that although there has been a constant tightening of regulation in this field – and obviously the regulation imposed by the CIFE had the most direct impact on the everyday practice of lending –, an ex post assessment of the compliance of the obligation to provide information in terms of content, this legislation has provided no legal significance. Details of the obligation to provide information with the right content have been defined by the still evolving judicial practice[79] and legal interpretation of the requirements of Directive 93/13/EEC on unfair terms in consumer contracts.

4.4.2. Period of risk management (2009–2010)

Obviously, the legislative measures of this period can only be seen as preventing the problems of the already concluded retail foreign currency based and retail foreign currency mortgage loan contracts, and were not able to eliminate the serious financial disadvantages that already occurred. Therefore, this era should no longer be examined in terms of the exchange rate risk and changes in the legal framework regarding the provision of information thereon, but it should be examined, on the one hand, in terms of the changes in rules for future risk taking and, on the other hand, in terms of the legislative measures taken to deal exactly with the crisis.

A) Change in risk taking rules

There has been a radical change in this area, as after having experienced the effects of the first shocks of the crisis and seeing the failure of banking self-regulation and supervisory recommendations, the Government Decree 361/2009 (XII. 30.) on the terms of prudent retail lending and the assessment of creditworthiness on prudent retail lending and creditworthiness was drafted. This decree introduced fundamental rules in the Hungarian lending market according to the following:

[77] See Article 13 and Annex 3 of the Act CLXII of 2009

[78] See section II/5 of Annex 3 of the Act CLXII of 2009

[79] See Judgement of the European Court of Justice, No. C-51/17. Of 20 September 2018 – http://curia.europa.eu/juris/document/document.jsf;jsessionid=FB11AC3452E2F1B169DE6DD805CC3468?text=&docid=205931&pageIndex=0&doclang=HU&mode=req&dir=&occ=first&part=1&cid=617382

- As of 1 March 2010, the loan-to-value ratio was introduced: the ratio of the contractual amount of the mortgage loan to the market value of the real estate collateral could be maximum 60% in the case of euro mortgage loans, while in the case of other foreign currency mortgage loans the maximum was 45%;
- As of 11 June 2010, purely collateral based lending has been abolished and creditworthiness checking and the limit established on the basis thereof have become mandatory. The minimum values of the limit were fixed in the Decree. In addition, a monthly repayment limit was set for foreign currency lending, which could be for euro loans 80% of the limits set by the bank for forint loans, and 60% for other foreign currency loans.

The regulation also contained rules as restrictions – that can now be considered trivial –, e.g. that the value of the debt covered by a mortgage already registered in the real estate register should also be taken into account in the calculation of the loan-to-value ratio. The regulation also set forth that if the lender charges lower interest rate and lower charges for a preferential period or provides a grace period for commencing the repayment of principal, the maximum repayment instalment after the end of the preferential period should be taken into account when checking compliance with the lending limit.

If we look at the regulation that introduces a significant tightening in terms of today's lending requirements, we could be surprised to find that the regulation did not set an income-based loan repayment limit, i.e. the maximum rate of a household's income that can be spent on loan repayment.[80] In addition, a loan-to-value ratio still did not have to be applied to retail mortgage loans secured by state guarantees, so the high coverage risk remained in the case of loans granted with state guarantee.

The definitive and categorical phasing out of foreign currency mortgage lending as a financial service available in Hungary was finally realised by the amendment of the 1959 Civil Code that entered into force on 14 August 2010[81]. This amendment stipulated that *"A mortgage cannot be established on a property owned by a natural person or on an ownership interest in a property owned by a natural person in order to secure a creditor's claim arising from the a natural person' – not including sole proprietors – loan agreement recorded in foreign currency or based on foreign currency, the parties' provision to the contrary shall be null and void."*[82] However, this measure can be treated as a symbolic rather than a real restriction, because by this time, foreign currency lending had already disappeared from the domestic lending practice. This was due on the one hand to the above-mentioned legal restrictions, which had already exercised their effect, and on the other hand, the materially changed attitude of borrowers and lenders based on their own discretion.

B) Crisis managing legislation

In the context of crisis management legislation, the legislature made a single law in the 2009 to 2010 period: this is Act XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in difficult situations due to taking loans for house

80 Regulation for the payment-to-income ratio was introduced as of 1 January 2015, by MNB Decree 32/2014. (IX. 10.).

81 Article 81 of Act XC of 2010 on the Adoption and Modification of Certain Economic and Financial Laws

82 Article 261 (4) of the 1959 Civil Code

purchase. With its entry into force on 27 November 2010, this amending law, by adjusting both the CIFE and consumer credit act, introduced a number of tightening effects, which have also had an impact on foreign currency loan contracts already concluded. According to the explanatory memorandum to the law, "*The Act provides mitigation solution for those who are trying to help themselves in their difficult situation. The support provided to them does not compromise the lending system, the solution cannot shake the mortgage lending system. The measures take account of the fact that the credit agreement is an economic transaction that, although it entails risks those risks must be borne jointly by the borrower and the lender. It is therefore necessary to incorporate guarantees in the inequality between debtors and lenders in the legal relationship at several points for the protection of the debtor.*"

The amendments brought about the abolition of the dual rate, the limitation of unilateral contract modifications, and the tightening of early payment charges and fees charged under other legal titles. This can be characterised as a major change. However, it is also important to note that in response to the significant social tensions that already existed, this law defined – by designating regulatory areas – the direction of crisis management as if the legislation would be able to help the situation of "consumers in difficult situations due to taking loans for house purchase". The reality, however, was that the really serious financial consequences were not caused by contract modifications or the use of different exchange rates, or by the excessive levels of bank charges, but by the effects of exchange rate changes. These resulted in a dramatic rise in repayment instalments and thereby in the severe payment difficulty or even insolvency of many households. In this situation, this amendment to the legislation was not able to alleviate the fact that the changes had to be applied also to the already concluded foreign currency loan contracts, by which it interpreted one of the basic principles of legislation, the prohibition of retroactive legislation[83] surprisingly permissively.

5. Summary

As a summary of the legal experience of foreign currency lending in the period 2004 to 2010, it can be primarily concluded that the subsequent interpretation of the legal environment of this period cannot be separated from the legal thinking of that era, which designated the range of interpretation of the individual legal institutions tainted by the participants' previous experiences and expectations that can be subsequently overridden, but was then considered legitimate. Thus, it could have happened that for long years, in Hungary, retail indebtedness in foreign currency would have been a great solution –surrounded by strong public consensus – that was a key means in terms of the available well-being for borrowers, spectacular credit and income growth for creditors and for the overall macro economy in terms of catching up with Western Europe.[84]

83 According to Article 12 (2) of then effective Act XI of 1987 on Legislation: "*The law may not impose an obligation before the date of its promulgation and may not declare any conduct unlawful.*"

84 "*In Hungary, the fast-moving credit growth that has started since the transition to the market economy is mainly explained by the catching-up process. Boissay et al. [2005], Backé et al. [2006] and Kiss et al. [(2006] showed that a large part of credit growth in most of the new EU member states, including also Hungary, can be explained by macroeconomic fundamentals.*" See: KIRÁLY – NAGY: opus cit 477.

The significant change in circumstances, the never-before-expected weakening of the forint has stunned both the professional and lay participants, and society faced a problem on a scale of which the solution meant an unprecedented challenge for all concerned. Unfortunately, the scale of the problem did not change the basic attitude of finding solutions, which can be described as follows: *"The parties to the transaction are driven by thousands and thousands of considerations on the conclusion of a transaction, from which the party, after the unpredictable disadvantage or advantage has emerged, only presents those that are expedient to eliminate this disadvantage or to maintain the advantage."*[85]

The immense retail foreign currency debt resulted not only in individual tragedies, but also in losses that shook the banking system. As a clear consequence of this, as is always in a conflict between parties, there has been mutual finger pointing, in which the law has become a tool, and everyone has tried to substantiate their respective truth with a legal argument. In the case of escalating disputes of exceptional size, a simplified casting of the weak and to be defended consumer against the "evil" bank has become accepted. This simplified search for truth, while understandable at an everyday level, is not suitable for identifying the real responsibilities and their share. Meanwhile, perhaps the most shocking result of this process – if only temporarily – was the loss of trust which is an inevitable element in a balanced bank-customer relationship.

However, beyond the bitter experiences of the crisis, events also offer an opportunity to examine whether or not these types of shocks can be prevented by the legal system and, if so, how. Today, we already know that, between 2004 and 2010, neither the basically underinformed borrowers nor the credit institutions destined for business success were suitable for assigning the risk limits of lending, as a particularly risky financial service. Although the legal system has been long looking at financial markets as an area to be strictly regulated in terms of foreign currency lending, however, the legislature's recognition has only occurred as a result of an extraordinary shock caused by a crisis. I do not think that borrowers will be much more prudent and lenders much wiser in the present. The prerequisite for the non-recurrence of the foreign currency lending crisis can therefore be the deterrent effect of the constraints set by a much more advanced regulatory environment.

[85] BÁTOR: opus cit 261.

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EXAMINATION OF ENFORCEMENT ISSUES RELATED TO CONSUMER CREDIT AGREEMENTS

1. Introduction

The exposure of households (consumers) to foreign currency and foreign currency-based debts stem from events that occurred more than a decade ago. Following the general elections of 2002, the government discontinued the popular state-subsidized forint loans in 2002 referring to budgetary reasons. As a consequence, the households opted for low interest rate foreign currency loans rather than for costly forint loans.[1]

In Hungary the conditions prevailing at the time of concluding the foreign currency consumer loans changed substantially after 2008 due to the effects of the unfolding international financial and economic crisis. In fact, whereas the Hungarian forint depreciated significantly, the euro and the Swiss franc appreciated strongly.

In 2008 90% of new consumer loans in Hungary were foreign currency-based. In the period between 2006 and 2009 foreign currency lending assumed such proportions that it became a danger for the entire Hungarian economy. The foreign currency loan portfolio of households grew from HUF 2,000 billion at year end 2006 to HUF 6,000 in early 2009. When the new government took office in 2010, foreign currency loans represented 50% of the country's external debt.[2]

As of 2010 the government sought to address the problem through effective legislation. The aim of the comprehensive action was to phase out household foreign currency loans as well as to help households hit by foreign currency debts.

In what follows I will highlight three key amendments to Act LIII of 1994 on Judicial Execution (referred to as Judicial Execution Act) that were adopted to attain the government's objectives as stated above. The first amendment dates from 2014, the other two from 2017. Before however describing these amendments, I will briefly present some of the government's measures that had preceded the 2014 amendment of the Judicial Execution Act and aimed at assisting foreign currency debtors.

2. Background

Due to serious exchange rate fluctuations, from the autumn of 2008 the number of new foreign currency loans dropped, at the same time the instalments of existing foreign currency loans were rising sharply. In order to tackle the situation, on 6 November 2008 the Ministry of Finance signed an agreement with eleven credit institutions playing a major role in the area of retail foreign currency lending. The agreement provided for instruments to mitigate the burdens of paying the increased instalments associated with the huge fluctuations of the forint's exchange rate. The credit institutions undertook to extend the repayment period without charging extra costs at the debtor's request and they also committed to convert foreign currency-based credits into forint-based loans. Moreover, the debtors who got into a difficult situation through no fault of their own could request the temporary relaxation of their repayment obligations. The agreement also provided for the flexible treatment of the prepayments of loans denominated in a currency other than the forint.

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1 A detailed description is available in: BODZÁSI Balázs: A devizahitelezés korszaka Magyarországon. Fontes Iuris, 2015/1. sz., 7-8.

2 http://www.mnb.hu/letoltes/fogyved-kockazati-2011h1.pdf

At the beginning of March 2009, Parliament adopted the act on government guarantees for home loans.[3] This enabled the Hungarian State to provide a guarantee for the capital and interest payments due under the bridge loans available to vulnerable debtors.

The government first interfered with the Judicial Execution Act during the next year in order to give a hand to debtors experiencing hardships. The amendment[4] consisted in adding a new section[5] to the transitional provisions of the Judicial Execution Act on the postponement of the enforcement of evacuation orders until 15 April 2015. These provisions, however, had to be applied also to the ongoing enforcement proceedings in which the evacuation of property was not executed until the entry into force of the amendment.[6] The amendment stipulated that postponement of the evacuation of properties would be governed by the provisions[7] of the Judicial Execution Act regulating the eviction moratorium during the winter season.

To help home debtors, the government and the Hungarian Banking Association agreed on a Home Protection Action Plan consisting of 5 points in May 2011. This included the introduction of a fixed exchange rate scheme, stricter conditions for foreign currency home lending, the extension of the home protection interest rate subsidy, gradual and limited auctioning as well as the establishment of the National Asset Management company. As for the government resolution on the strengthening of the situation of foreign currency debtors[8], it set up a short-term action plan to mitigate the problems related to foreign currency debtors.

The government submitted to Parliament its legislative proposal in June 2011 on fixing the exchange rate of the repayment of forex loans and on the forced foreclosure procedure of residential property, which entered into force on 30 June 2011 upon its adoption.[9] The objective of fixing the exchange rate was to temporarily mitigate the effect of the fluctuations of the relevant currencies and thereby render the situation of foreign exchange debtors predictable. For those participating in the scheme, the act fixed the repayment exchange rate of the Swiss franc-based loans at 180 forints, of euro-based loans at 250 forints and of yen-based loans at 2.5 forints for a grace period not exceeding 60 months. The creditor offered a special forint mortgage loan, that is opened a special account to collect the difference between the fixed rate and the actual market rate of the repayment. This loan was covered by the same residential property that was used for the foreign currency-based loan and it could not expire earlier than the foreign exchange loan. During the application period of the fixed rate, the Hungarian State as guarantor was liable for 100% of the debts accumulated on the special account. Following the application period of the fixed exchange rate it remained liable for 25% of such debts as fallback guarantor.

In order to give social protection to defaulted debtors, the act prohibited the auction of the affected real estates until 1 July 2011, that is it declared a moratorium on auctions. Besides this moratorium, the act also set forth that owing to the quota system on forced foreclosures that also regulated auctions, the enforcement of home debts could only take place gradually even after this date.

3 Act IV of 2009 on government guarantees for home loans

4 Act LXXXI of 2010 on the amendment of Act LIII of 1994 on Judicial Enforcement

5 Section 303 of the Judicial Execution Act

6 The amendment entered in force on 11 August 2010 and postponed real estate eviction until 15 April 2011.

7 Section 182/A of the Judicial Execution Act

8 Government Resolution 1191/2011. (14 June) on strengthening the situation of foreign currency debtors

9 Act LXXV of 2011 on the fixing of exchange rates used for repayments of foreign exchange-denominated mortgage loans and the administration of the forced sales of residential property

On 15 December 2011 the government concluded an agreement with the Hungarian Banking Association that required credit institutions to extend and to further ease the foreign exchange cap scheme until the end of 2012 for debtors.

The government decree on housing interest subsidy[10] was adopted in the framework of the Home Creation Programme of the government. Provided that certain conditions were fulfilled, subsidies could be applied for. By passing the act amending certain laws related to household protection[11], Act CXII of 1996 on credit institutions and financial enterprises (former Act on Credit Institutions) was also amended. Thus, the government enabled foreign currency mortgage debtors to repay their loans at preferential rates.

Special mention should be made of the acts of 2014 (the so-called DH Acts) among measures aimed at settling the situation of foreign currency debtors. Owing to the act (referred to as Act DH)[12] , the provisions of the Civil Law Uniformity Decision 2/2014 of the Curia became applicable to all foreign currency debtors without the necessity of taking legal proceedings. First and foremost, it helped avoid hundreds of thousands of lawsuits for the declaration of the nullity of the so-called exchange rate margin. Additionally, Act DH1 established a rebuttable presumption of the unfairness of contractual clauses providing for the opportunity to amend the contract unilaterally, as well as laid down special provisions for managing pending actions related to foreign currency loans. It is also worth noting that in Decision 34/2014 (14 November) the Constitutional Court rejected the initiative of judges to establish that Act DH1 was not in harmony with the Fundamental Law of Hungary and to annul it.

The subsequently adopted Settlement Act (Act DH2)[13] established the settlement obligation of financial institutions towards consumers. The settlement procedure concerned altogether 3.6 million consumer loan contracts and resulted in the payment of around 750 billion forints representing claims from consumers. As a result of settlement, the outstanding principal debt decreased and the monthly instalments were reduced by 25% on average.[14]

This was followed by the Conversion Act (Act DH3) that was closely linked to previous government measures and was in line with them.[15] The Act laid down the criteria, legal technique as well as the procedures of conversion into forints for residential mortgage loan contracts to which the settlement applied and for financial leasing contracts for real estate. The act furthermore set forth that consumer loan contracts affected by conversion into forints should be governed by the new contractual terms defined in the Fair Banking Act (Act DH4)[16].

The acts on foreign currency loans required the amendment of the Judicial Execution Act. The purpose of the present paper is to provide an overview on how legislation adopted to settle the situation of foreign currency debtors impacted on the rules of judicial enforcement.

10 Government Decree No. 341/2011 (29 December) on housing interest subsidy

11 Act CXXI of 2011 on the amendment of certain laws related to home protection

12 Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of consumer loan contracts entered into with financial institutions.

13 Act XL of 2014 on the rules of settlement regulated in Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of the consumer loan contracts entered into by financial institutions, and certain other provisions.

14 http://www.mnb.hu/sajtoszoba/sajtokozlemenyek/2015-evi-sajtokozlemenyek/az-elszamolas-es-forintositas-mind-az-orszag-mind-az-adosok-helyzeten-erdemben-javitott

15 Act LXXVII of 2014 on amending Act CLXII of 2009 on credit provided for consumers and other related acts.

16 Act LXXVIII of 2014 amending Act CLXII of 2009 on consumer loans and certain related Acts.

3. The Significance of Judicial Enforcement

In one of its early decisions the Constitutional Court underlined that: „*Respect for court rulings, the execution of final court decisions -including the application of legitimate enforcement- belong to the constitutional values related to the rule of law. If the enforcement system is weak and easy to circumvent, that will inevitably lead to the underestimation of court decisions, to legal uncertainty, to the decline of legal consciousness, to the infringement of the principles of rule of law. Combatting such a menace is apparently a matter of constitutional interest for citizens, society and the State.*"[17]

The passage quoted from the CC decision highlights the fact that the adequate functioning of the system and procedures of judicial enforcement is an essential matter with respect to the rule of law and the entire society.

Laws are mostly obeyed through voluntary compliance. In the absence of this, the norms based on social consensus must be enforced by the State's coercive power. Judicial execution is one of these coercive proceedings. Judicial execution is necessary to enforce the decisions of courts and of other dispute resolution bodies (e.g. public notaries) as well as to recover claims based on enforceable decisions and certain acts.[18]

Civil procedural law governs two sets of procedural rules: litigious and non-litigious proceedings. Judicial execution belongs to non-litigious proceedings and it aims to give effect to state pressure in the interest of enforcing the rightful claim of the party seeking enforcement. In the meantime, state pressure may only be used if the debtor fails at voluntary performance.

Despite the fact that the public perception of the role of executors (bailiffs) is far from being favourable, it should be stressed that executors exercise extremely important tasks of public authority by enforcing final court decisions. This important public authority, the competent and effective regulation of the enforcement proceedings as well as the regular inspection of the executors' activities confer a heavy task and responsibility upon the legislature.

The enforcement proceedings must in any event meet two essential principles: the protection of the debtor/the obligated party on the one hand, and on the other the respect of the interests of the party seeking enforcement/the creditor as well as the effective enforcement of the claim.[19] These principles should be upheld by complying with the strict rules laid down in legislation, and in particular the Act on Judicial Execution.

The period of „Socialist enforcement law" before 1990 used to be characterized by low-efficiency enforcement proceedings. This can mainly be attributed to the fact that Socialist law sought to use the power of persuasion to convince debtors to perform claims. It is evident therefore that a shift occurred towards the principle of the protection of debtors.[20]

After the political changeover a plethora of economic actors entered the scene, resulting in an increased number of contractual transactions concluded between them, of the resulting legal disputes as well as that of the parties failing to perform their obligations on a voluntary basis. This required defining new procedures and setting up new structures after 1990.

17 CC Decision 46/1991 (10 September)

18 VIDA István: *A bírósági végrehajtás*. Közgazdasági és Jogi Könyvkiadó, Budapest, 1978. 381.

19 SZILBEREKY Jenő - NÉVAI László: *Polgári eljárásjog*. Tankönyvkiadó, Budapest, 1976. 652.

20 KENGYEL Miklós: *Magyar polgári eljárásjog*. Osiris Kiadó, Budapest, 2012. 652.

Parliament adopted the Act on Judicial Execution in 1994. Owing to the Act, the rules on enforcement proceedings were further developed and the structures of enforcement were radically transformed to comply with the rule of law.

The Judicial Execution Act of 1994 created the institution of independent judicial officers as the general organizational form of judicial enforcement. In the new structure, the body in charge of execution was separated from the court structures, and the Minister of Justice was charged with its supervision. The status of the judicial executor could (and can still) be regarded as a *sui generis* legal institution in the newly created structure. In fact, the judicial executors perform their activities of public authority as entrepreneurs (employed by a registered company) distinct from the institutions of state power in their stricter sense. The legislature therefore permanently seeks to ensure that that the control and state supervision of judicial executors should also be performed within a strict legal framework.

4. The Position and Role of Judicial Enforcement

In order to be able to assess the social and economic significance of judicial enforcement, its position within the enforcement system needs to be identified.

Judicial enforcement is a civil non-litigious procedure in which the court or another body authorized to enforcement implements the sanction targeting the performance or the granting of an obligation by way of material coercion.

Civil non-litigious procedures have been regulated in Hungary since 1881 in a separate act[21]. Thus, in judicial enforcement procedures material coercion may be applied to ensure that the person liable for payment or other behavioural commitments performs his obligations.

The claim to be enforced during the procedure can either be material or criminal. In the case of material claims execution might either target the recovery of financial claims or the performance of the defined action. Both the recovery of financial claims and the performance of the defined action can be achieved under a judicial or administrative enforcement procedure.

Enforcement may be carried out by either penitentiary or material execution. Within material execution a further distinction can be made between single (singular) execution and universal (total) execution. The single execution procedure concerns certain property items, property elements and property rights of the debtor and does not affect the debtor's legal personality. Universal property execution by contrast seizes the whole property of the debtor in order to satisfy the claims. As a consequence of total execution, the debtor operating as a legal entity also loses its legal personality. Typical cases of total execution are winding-up procedures.

In Hungarian law, single execution may be conducted in three ways, namely by:[22]

a) judicial enforcement,

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21 Act LX of 1881 on enforcement procedures

22 NÉMETH János - VIDA István: *A bírósági végrehajtás magyarázata.* KJK-KERSZÖV Jogi és Üzleti Kiadó Kft., Budapest, 2004. 120.

b) administrative enforcement, and
c) direct enforcement.

Two types of direct enforcement may be distinguished:
a) direct judicial order of garnishment[23] , and
b) direct judicial notice[24].

Direct enforcement is carried out by bodies that do not qualify as either judicial or administrative authorities. In the event of direct enforcement, the claim may only be settled by deduction from amounts – like wages and other remuneration – due to the debtor. Deduction is not ordered by the executor, but by the court. Employers for instance might be entitled to deduct sums from the wages and other remunerations of the employee up to the rightfully claimed amount.[25]

As regards their purpose, enforcements might be further grouped into safeguard enforcements and claim satisfaction enforcements. The aim of safeguard enforcements is to secure the enforcement of the claim at a later date. It can be applied in cases when although the conditions for claim satisfaction enforcement are not met, it appears likely to the creditor (entitled party) that the satisfaction of its claim at a later date is at risk. The goal of claim satisfaction enforcements, by contract, is the immediate and full enforcement and satisfaction of the claim. In accordance with the Judicial Execution Act, safeguard enforcements may be ordered by means of issuing a financial claim or applying a specific restriction.[26]

The basic aim of judicial execution is to enforce the creditors' claims that have not yet been honoured by the debtor. Each of the provisions pertaining to the enforcement procedure were designed to create a balance between two mutually recognizable interests: those of the claimant and the debtor. It should be underlined, however, that creditors' claims do not only constitute claims of financial institutions. The debtor's real estate property could be subject to auctioning and eventual evacuation due to failure to meet other private law claims like child support, public utilities fees and amounts owed to private individuals. Therefore, debtors could be constrained to leave their residential property due to failure to pay their bank loans. If the debtor did not request payment by instalment or did not pay back the amounts owed, the evacuation of real estate property could take place in the framework of an enforcement procedure ordered on any grounds.

5. Temporary Extension of the Eviction Moratorium

Among the measures aimed at settling the situation of foreign currency debtors and affecting enforcement procedures, Act XVII of 2014 amending Act LIII of 1994 on judicial executions should be first mentioned. The amendment entered into force on 16 May 2014. By virtue of the Act, residential property evacuations were postponed until the period following the

23 Section 24 of the Judicial Execution Act
24 Section 28 of the Judicial Execution Act
25 NÉMETH - VIDA: i.m. 185.
26 Section 185 of the Judicial Execution Act

expiry date of the evacuation moratorium to be defined in a separate act that was to settle the situation of foreign currency debtors.[27] This separate act was to be called the Settlement Act.

Owing to this amendment, the period of the eviction moratorium was actually extended. [28]Rather than modifying the principal rules on the period of the eviction moratorium, the amendment extended the moratorium until a specific date in the future. In fact, the amendment was included in the transitional provisions of the act, after the expiry of which the principal rule of the Judicial Execution Act was applied anew.

Pursuant to the amendment of the Judicial Execution Act, the postponement of the evacuation of residential property was applied to transactions in which the debtor's residential property was subject to enforcement due to debts arising from a foreign currency loan contract. After the entry into force of the act although the bailiff was entitled to implement an enforcement action and could auction residential property, he could not take measures to evacuate residential property.

6. Staying of Enforcement Procedures

In accordance with Act DH1 the enforcement proceedings associated with claims arising from consumer credit and loan contracts as well as financial leasing contracts (hereinafter referred to as consumer loan contracts) were staid.[29] These provisions of the act were to be applied as of 26 July 2014, that is pending enforcement procedures were staid as of 26 July 2014 by virtue of the law.

There were two exceptions to these rules in cases when the enforcement procedure initiated to collect the claim originating from the loan contract was under suspension on the day of the entry into force of Act DH1. One of the exceptions was when the debtor was granted instalment payment, the other being when the employer or the organ disbursing the remuneration confirmed that the deduction was registered and taking other measures was neither possible or necessary. In these cases, the enforcement procedure could not be stayed automatically, but only at the debtor's request. These two cases were therefore exceptions from the automatic staying effect imposed by the act. Although it was possible to have the enforcement procedures stayed even in these cases, this was subject to the action and request of the debtor.[30]

Staying as a notion had been unknown to enforcement procedures before the entry into force of Act DH1. Thus, stayed enforcement procedures constituted a separate sui generis category within the realm of enforcement proceedings. Staying implied that in enforcement procedures initiated to collect the claim originating from the loan contract pending on the day of the entry into force of Act DH1 no action or measure could be implemented until the date specified in the separate act (Settlement Act), irrespective of the phase of the procedure in question. Furthermore, the statements made by parties and other interested parties also became ineffective. All time limits were suspended until the date specified in the act and commenced again thereafter.[31]

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[27] Section 303 of the Judicial Execution Act

[28] At the time of the entry into force of the amendment, the eviction moratorium lasted from 1 December to 1 March

[29] Section 17(2) of Act DH1

[30] Section 17(2) of Act DH1

[31] Section 17(3) of Act DH1

After the entry into force of Act DH1 the obstacles had been removed from submitting an enforcement request and thereby from initiating the enforcement procedure. Apart from initiating the procedure, however, no other procedural actions or measures could be implemented and no valid statements could be made either. Requests for enforcement could be submitted, since failure to do so might have jeopardized the enforceability of the claim due to the time limitation, but the bailiff could not implement procedural actions and thus could not ensure the enforcement of the claim either. In fact, by virtue of the provisions of Act DH1 once the enforcement procedure was initiated the claim did not expire due to the interruption of the time limit.

Judicial executors were required to record the enforcement case as interrupted if no measures or procedural actions were taken in accordance with Act DH1. The staying of enforcement procedures was also applicable to other enforcement procedures initiated against the debtor to collect claims if the procedures concerned asset(s) seized during the procedure associated with the consumer loan contract.[32] This included cases initiated to enforce other claims joined by the pledgee.

In selling the assets seized during the enforcement procedure associated with consumer loan contracts, the executor had to take into account one of the key principles of the Judicial Execution Act, namely graduation,[33] as well as the determination of seniority.[34] As the bailiff's hands were tied with regard to the asset, he could not implement measures relative to the sale of assets not associated with the consumer loan contract, one of the reasons being that pursuant to Act DH1 he could not divide the amount in the enforcement case associated with the consumer contract loan, satisfy the creditor as well as have the foreclosure removed from the record. It is important to note, however, that the debtor could not spontaneously pay the amounts owed during the staying period. At the same time, the claim of the creditor increased gradually during the staying period to the degree defined in the enforcement order.

The entry into force of Act DH1 resulted in the massive staying of enforcement proceedings. In these cases, the executor could not take any measures, including the implementation of real estate property evacuation.

It was obvious, however, that this state of affairs could not be maintained for a longer period. As a matter of fact, the parties seeking enforcement – and not just the holders of consumer loan contracts– could not access their claims. Debtors, on the other hand, could not pay their debts even if they intended to do so due to the stayed enforcement procedures. Also, debtors did not honour their other payment obligations, either. They could be sure that as a result of staying affecting all enforcement procedures, the auctioning and the evacuation of their seized real estate property will not take place for some time. All in all, payment discipline became considerably poorer.

32 Section 17(5) of Act DH1

33 Section 7 of the Judicial Execution Act

34 Section 165 of the Judicial Execution Act

7. Resumed Enforcement Procedures

The Settlement Act set out the detailed rules on bank settlement following the termination of lawsuits based on Act DH1. The Settlement Act required financial institutions to comply with their settlement obligations and it also set out the rules of resuming enforcement procedures stayed on the basis of Act DH1.

The financial institution was obliged to send the statement of settlement to the debtors with regard to all consumer loan contracts as required by the Settlement Act. The financial institution was obliged to send a notification to the executor on having sent the settlement statement to the debtor within 30 days and was also required to send the settlement statement to the executor at the same time. Following this, the executor was required to resume the previously stayed enforcement procedure within 60 days. In accordance with the Settlement Act the enforcement procedure was stayed until the 30th day following the notification by the financial institution. As a consequence, the executor could not resume the procedure until the 30th day following the notification, but then was obliged to resume it within 60 days.

The only exception to the above requirement was a case in which the financial institution did not notify the executor. In such cases the procedure could be resumed after 31 December 2016 at the latest. Thus, all enforcement procedures resumed after 31 December 2016 at the latest.

The provision on the final deadline was necessary because thereby it was ensured that possible omission of the financial institution could not prevent resuming enforcement procedures against debtors. In the event that the financial institution failed to comply with its obligation to notify the executor in accordance with the Settlement Act, the enforcement procedure was not stayed any longer after 31 December 2016, but the case was suspended from this date. The executor therefore registered the case as suspended from this day, that is the deadlines and the limitation started again while other enforcement procedures resumed.

Enforcement procedures were resumed with the procedural step at which they had been stayed. The executor therefore did not always resume the procedure by implementing the evacuation of the real estate property.

Act XVII of 2014 amending the Judicial Execution Act postponed the implementation of the evacuation of residential property to the period following the date of the eviction moratorium specified in the Settlement Act.[35] Taking into account the eviction moratorium, the evacuation of the residential property laid down in Section 303 of the Judicial Execution Act could resume within 30 days of notifying the executor or at the latest after 31 December 2016. It is worth noting in this context that Section 303 applied only to already sold residential property. Evacuation could only occur when the property had been sold. It should also be kept in mind that Section 303(9) of the Judicial Execution Act applied to a narrower scope of contracts than Act DH1 or the Settlement Act. The scope of application of Section 303 of the Judicial Execution Act did not extend to consumer loan contracts not secured on mortgage. In these cases, as a general rule the evacuation of residential property

[35] Sections (1) and (4) of the Settlement Act

could be completed nearly immediately after notifying the executor about the settlement. Nevertheless, the eviction moratorium had to be kept in mind in such cases, too.

The above shows that the impact of Act DH1 and the of Settlement Act on enforcement procedures was rather significant and went beyond the foreign currency debtors' enforcement cases. In fact, the acts had the effect of staying every enforcement procedure against foreign currency debtors, and as a consequence often no returns were realized in these cases for a long time. At the same time the amount of the claims was increasing continuously since the acts stipulated only with respect to the limitation period that no further deadlines would be set. These acts did not allow for voluntary performance by debtors within the framework of enforcement procedures, with the exception of agreements on instalment payment and the confirmation of deductions originating from the period preceding their entry into force. All in all, while the effectiveness and efficiency of enforcement procedures decreased, the amount of the claims increased.

8. Further Measures to Improve the Situation of Debtors

8. 1. The Introduction of Personal Bankruptcy

The settlement of foreign currency loans, the exchange rate peg, the conversion into forints, as well as the staying of enforcement procedures all helped to address the problem of severely indebted households. The government nevertheless believed that further measures were needed to restore the solvency of certain groups. The Personal Bankruptcy Act was devised to assist foreign currency debtors and other debtors in serious difficulty. (Private Bankruptcy Act).[36] The Act entered into force on 1 September 2015 and introduced a brand new legal instrument in the Hungarian legal system.

The Personal Bankruptcy Act provided for settlement procedures in order to have the debts of individuals with payment difficulties settled within a regulated framework and thus restore their solvency. The legal instrument, however, did not seek to save either the population groups that had incurred multiple debts or those who were much wealthier than the average.

The personal bankruptcy procedure could only be initiated on a voluntary basis. Insolvent debtors had to consider at their own discretion the benefits associated with the procedure as well as the obligations to be undertaken in exchange for them.

The legislature intended to prevent the situation of debtors and the family members living together with him from becoming economically unfeasible by means of a settlement framework that could be joined voluntarily. In many respects this procedure was more advantageous for debtors than either the enforcement procedure or the non-procedural enforcement of the real estate secured on mortgage. Families with payment difficulties were granted protection against bankruptcy already in the early stage of the settlement procedure. That is, they were

36 Act CV of 2015 on the debt settlement of natural persons

protected from enforcement procedures, non-procedural forced sales during the procedure and could initiate the settlement of their debts with help from the State.

If a private bankruptcy procedure is successful, the debtor can get rid of a significant part of his debts within a reasonable time and by co-operating with the creditor, he might even be able to keep his residential property. If the debtor makes payments during the five-year repayment period in an orderly manner and the creditors access the minimal return defined by law, the court may exempt the debtor from paying the remaining debt.

8. 2. Provisions ensuring the debtor's housing during the enforcement procedure

Simultaneously with the entry into force of the Private Bankruptcy Act, the Judicial Execution Act was complemented with a provision requiring the party seeking enforcement with respect to residential real estate properties (holiday homes) and their buyers at auctions to notify the local notary. Pursuant to this amendment, as of 1 September 2015, the party seeking enforcement was obliged to notify the notary of the locality in which the property is situated about the seizure of the property. As for the buyer at the auction, he was required to notify the notary of the locality in which the property is situated about the evacuation of the residential property. As of 1 July 2016, this notification requirement has been transferred to the executor.[37]

The legislature thus sought to ensure that the debtor and his family owning residential property (a holiday home) would only be obliged to leave their property if the notary has attempted to provide them with housing within the available limits. This amendment primarily supports debtors who are not able to initiate a private bankruptcy procedure.

8. 3. Ensuring the sale of residential properties at the highest possible price during the enforcement procedure

The amendment of the Judicial Execution Act for the further protection of debtors that entered into force on 21 March 2017[38] specified that in the case a residential property is auctioned in an enforcement procedure initiated to collect the claim arising from the contracts concluded with the consumer, the valid purchase price should reach at least the property's valuation price. In fact, the party seeking enforcement may only take over the property at a price corresponding to the valuation price. By introducing the amendment, the objective was to have seized property sold at as high prices as possible and also to realize the highest possible returns on existing claims. At the same time, this measure did not only take into account the protection of debtors, but the interests of the parties seeking enforcement as well by setting as an objective the realization of the highest possible returns on the claims.

It should be stressed that the scope of claims arising from contracts concluded with consumers is larger than that arising from consumer loan contracts affected by Act DH1 or the Settlement Act. As a consequence, the limit relating to the minimal sale price affected a significant proportion of enforcement procedures.

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37 Sections 138/C and 154/A(11) of the Judicial Execution Act

38 Act XIV of 2017 amending Act LIII of 1994 on judicial execution.

In accordance with Section 147(3) of the Judicial Execution Act in force as of 21 March 2017: *„A valid purchase offer for residential property can only be made at a sum corresponding to minimum 70% of the starting auction price -or a sum corresponding to the starting auction price for enforcing claims arising from contracts concluded with a consumer -if this is the debtor's sole residential property, he dwells here and he was staying here for the 6 months prior to initiating the enforcement procedure."*

Therefore, if the enforcement procedure was initiated to collect a claim arising from a contract concluded with a consumer, the residential property may only be sold minimally at its starting auction price (valuation price). In the absence of these conditions, the residential property can only be sold at minimally 70% of the starting auction price. If, however, the real estate does not qualify as residential property pursuant to Section 147(4) of the Judicial Execution Act, it can be sold at minimum 50% of the starting auction price (valuation price).

The rule on the higher minimum selling price laid down by the Judicial Execution Act decreased the number of successful auctions and sales after its entry into force. As a consequence of fewer auctions and sales, the number of evacuations also diminished. Thus, the amendment had a direct effect on evictions, too.

Due to the increase of the market price of real estate, the marketability of properties during enforcement procedures has remained at the same level in certain parts of the country, while in other parts it has lessened. The marketability of real estate properties in Budapest and its agglomeration as well as in big cities has not fallen, enabling a number of the parties seeking enforcement to benefit from the new rules. This is also advantageous for debtors, since return on their debts is realized at the highest possible rate. Moreover, their property could be purchased at such a high price that they might even be entitled to some money from the sales.

As a result of the fact that the amendment increased the minimum price of residential property as defined by the act to 100% of the valuation price, the marketability of properties located in small settlements dropped considerably. As the property would not sell, any debtor in possession of such a property had greater chances of staying in the property for an indefinite period without repaying his debts. This situation does clearly not encourage a debtor not wishing to perform voluntarily to repay his debts or sign an agreement on instalment payments.

As established in the Judicial Execution Act, these new provisions should be applied in ongoing enforcement proceedings in such a manner that they should be observed when announcing the next auctions.[39] In addition, the new rules should also be applied to cases in which the auction had been announced prior to the entry into force of the amendment, no valid purchase offer was available on the date of the entry into force.

As a result, the executor was obliged to examine without delay for each announced auction whether a procedure had been initiated to collect the claim arising from the contract concluded with the consumer. In case such procedure had been already launched and the case involved residential property, moreover the above conditions are jointly met, he was required to delete the announcement from the Electronic Auction Surface. Besides notifying the parties of the deleted announcement, he was required to make a new announcement in line with the amended rules.

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39 Section 306/X(1) of the Judicial Execution Act

The amendment also provided for numerous options for making a purchase offer inferior to the valuation price during the auction of a residential property for which a claim was made in an enforcement procedure arising from a consumer contract. This happens if one year has passed since the publication of the announcement of continuous auction with regard to the residential property and it has still not been sold. In this case a valid purchase offer can be made at 90% of the starting auction price (valuation price) at the next announced auction.[40]

Importantly, these new provisions were not foreseen for a transitional period, they are in place even today.

8. 4. „Walking away" during the enforcement procedure

The amendment of the Judicial Execution Act that entered into force on 21 March 2017 enabled parties (the debtor and the party seeking enforcement or in the case of more than one enforcement, all the parties requesting enforcement) to agree on auctioning the property at a lower price. Such price is the proportion of the starting auction price (valuation price) agreed by them at which a purchase offer can be made. The Judicial Execution Act does not set any floor, but leaves the parties free to define the amount of the minimum price. The parties can thus divert from the principal rule (100%, 70%, 50%).

The property announced for auctioning at this minimum price may be auctioned successfully at a price that constitutes more than 100% of the starting auction price (valuation price). As a matter of fact, bids can be made above the minimum amount decided upon by the parties, there is no ceiling in this respect. The parties merely agree on the amount of auctioning at a lower price, but cannot predict the amount of the maximum bid at the closing of the auction.

One of the key new elements of the amendment is that in such cases following the successful auction of the property and the division of the amounts resulting from the auction between the parties seeking the enforcement, all the remaining debts of the debtor are cancelled vis-a-vis the parties requesting enforcement. This is the so-called *walk away* option that had not been regulated in Hungarian law before the amendment of the Judiciary Execution Act. It should be emphasized that this option is not only available with regard to debts to financial institutions.

Owing to the introduction of the walkaway option, the debtor may get rid of all his debts after the auctioning of his residential property by the power of law. This typically occurs when the sale of the debtor's property was - perhaps repeatedly – unsuccessful, but the debtor wishes to free himself of the debt. An additional condition, however, is that the parties seeking enforcement should also be willing to agree with the debtor.

8. 5. Extension of the eviction moratorium

The rules on the winter evacuation moratorium was amended by the legislature as of 11 November 2017. In accordance with the amendment,[41] the Judicial Execution Act put off the implementation of the evacuation of the residential property in case the obligated

[40] Section 159(8) of the Judicial Execution Act

[41] Act CXXXV of 2017 on the amendment of Act LIII of 1994 on Judicial Execution

party/debtor is a natural person for a period following the period between 15 November and 30 April (this replaced the period between 1 December and 1 March laid down in the former provision). As a result of the amendment the eviction moratorium was extended. The legislature thus offers help to the debtors during the most critical winter season. The amended provision was to be applied to enforcement procedures pending on the date of its entry into force in which the residential properties had not been evacuated yet.

It is essential to note with respect to the amendment that whereas the former extension of the eviction moratorium had been transitional, this amendment is not transitional and is not linked to any deadline.

The time period of the eviction moratorium affects the successful selling of residential properties during the enforcement procedure, the return on claims as well as the debtors' willingness to pay. In fact, in many cases it entails that the buyer at the auction may only take possession of the purchased property after a longer period of time following the auction.

It is to be noted, however, that the period of the eviction moratorium does not need to be considered in the course of evacuating every property. An exception is made in the case of vacating arbitrarily occupied dwellings, if a disciplinary fine was imposed on the obligated party, or if the obligated party is not a private individual.

A further important aspect is that statistical data on property evacuation and the transfer of possession do not necessarily coincide with data on evictions. In accordance with the Judicial Execution Act, evacuation of the property occurs also if the debtor leaves the property on a voluntary basis and if the property had been empty at the time of selling. In the latter case evacuation or the transfer of possessions does not take place through police intervention. Therefore eviction really means the evacuation of property through police intervention.

9. Summary

As of 2014 the Hungarian legislature has been devising measures that have quickly and efficiently addressed the legal consequences of the unfairness of contractual clauses included in consumer loan contracts that affected a large group of consumers. During settlement by legislation of the issues related to consumer loan contracts, one of the essential considerations was the protection of the consumer who was unfamiliar with economic and financial processes and was deemed as the weaker party in representing his interests. In line with these considerations, the rules with regard to enforcement proceedings laid greater emphasis on the protection of debtors in the last few years. The vast majority of enforcement procedures related to the acts on foreign currency loans have either been resumed or closed. The number of enforcement procedures which are currently in the suspension phase due to staying is insignificant.

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THE PROPERTY MARKET AND MACROECONOMIC FACTORS OF FOREIGN EXCHANGE LENDING, AS WELL AS ITS COMPARISON TO THE CURRENT CREDIT CYCLE

[1] I would like to thank Balázs Erdélyi for his support provided during the study, and my colleagues for their valuable comments.

1. Introduction

The aim of the study is to examine domestic foreign exchange denominated lending, primarily in respect to housing loans. The analysis also covers the period before the proliferation of foreign exchange credits and the period following their successful phase-out. The focus on property loans is justified by the fact that, although foreign exchange credits were present in a substantial volume in both personal credits and vehicle loans, the property market is an important factor for several national economic reasons. On the one hand, property credit generally incurs repayment obligations for households for decades, on the other hand housing is the most important asset of most households. Due to the above, the redemption of credit and the fluctuation of the property's value permanently and significantly influences the disposable income, and the financial standing of households.

Further to this, the quality of long-term property loans fundamentally influences bank lending. Should borrowers not be able to fulfil their payment obligation in time, this can lead to an increasing necessity for the banks to build up reserves, due to which their lending ability is reduced. The high proportion of bad credit can therefore reduce lending for a long time, and through this reduce demand in the economy as well.

The availability of property loans is also decisive in respect to demand on the property market, which also influences the amount of newly built homes, and consequently the renewal rate of the housing stock as well. An adequate supply of new housing is also important in respect to labour mobility, since a failure to provide proper housing means that the labour flow into certain regions will lead to increasing prices, which further limits mobility. The availability of affordable and good quality housing is also important in respect to demographic processes. Namely, if the majority of household income is tied up in high housing costs, or only poor quality housing can be provided, or it is far from work opportunities and not cost-effective, this reduces the tendency to have children.

During the period following the political and economic changes there were three periods when housing credit boomed. First, in the early 2000s, thanks to the introduction of subsidized (HUF) housing loans in a high interest rate environment. Soon after the substantial reduction of subsidies, foreign exchange lending took over the role of HUF loans, which dominated the credit market up until the crisis. Afterwards, the volume of lending fell again, and following the successful management of the inheritance of foreign exchange credits in several stages, the opportunity to increase housing credit was opened up again.

In the following sections, we will first review the long-term lending trends and the property market, then we will address the period after the change in the political system and the introduction of housing loans, followed by the proliferation of foreign exchange credits. Finally, we will compare the current period to the foreign exchange credit boom period.

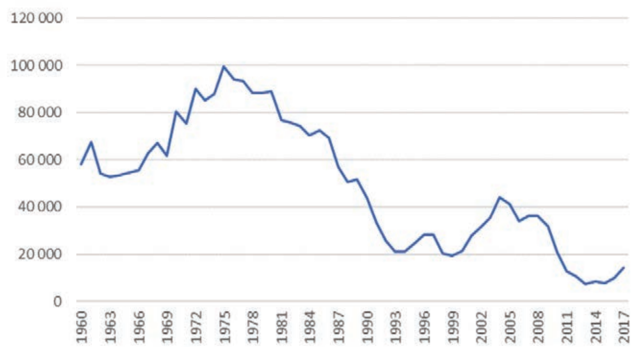
2. Long-term trends in housing construction

By analysing the period since 1960 it can observed that the first big housing construction boom was in the 1970s, when nearly 90 thousand dwellings were built on average annually. On the one hand, it was a result of family policy measures introduced in 1973, and on the other hand it was a period when the more populous generation, i.e. the people born during the Ratkó-period (born in the 1950s) reached the age when they were able to have their own families. The rising number of births was followed by an increase in the number of constructed new homes (Fig. 1). Family policy measures also contributed, as they eased the access to housing by providing rented flats – owned by the local governments – for families with three or more children within a fairly short period of time, and interest-free or subsidised loans for newly married couples. In addition, families could also apply for a housing subsidy if they committed themselves to having children later. If children were not born, the subsidy was capitalized as part of the credit. It must be noted, however, that a substantial number of the homes built during this period were in big blocks of flats produced in a so-called house factory style, which means that these residential areas were too congested and therefore less comfortable. Following this peak period, the end of the demographic peak was followed by a moderation in the number of constructions.

According to estimates based on international experience, the 26,500 flats built on average annually after the change in the political system between 1990 and 1999, were not enough to achieve an acceptable rate of renewal. Based on the estimate by the MNB conducted in 2016, the number of annually built new dwellings necessary to maintain the quality of housing was nearly 40 thousand (MNB, 2016), which represents an annual renewal rate of roughly 1 per cent. The 0.6 rate of the 1990s fell significantly short of this figure. If we add that the number of dwellings per household in Hungary is lower than the Eurozone average, and that the existing housing stock of the 1990s was quite amortized, and fell behind the Western-European standard in terms of comfort, energy efficiency and in other respects too,[2] then the number of new housing construction needed to increase the quality of housing considerably exceeded the estimate of 40 thousand.

Besides the state subsidy and the demographic processes, the demand side of the housing market in a market economy was primarily influenced by the long-term income expectations of households, their net financial situation and credit market conditions. Consequently, following the change in the political system, during the transformation crisis – as a result of deteriorating lending conditions due to decreasing household income and high inflation as well as decreasing subsidies – the number of housing construction plummeted and reached its nadir in 1999 with less than 20 thousand units built (Fig. 1).

Figure 1: Long-term development in the number of new dwellings completed (pieces)



Source: KSH

[2] Based on the figures of KSH, only 74.1 per cent of flats had water-flushing toilets (water closets) while only 78.3 per cent had bathrooms in 1990.

The next wave of the housing boom was initiated by the introduction of subsidised housing loans in 2000, followed by more beneficiary conditions the following year. However, the subsidies fell considerably in 2003, therefore lending fell again until the proliferation of foreign exchange credits about a year later.

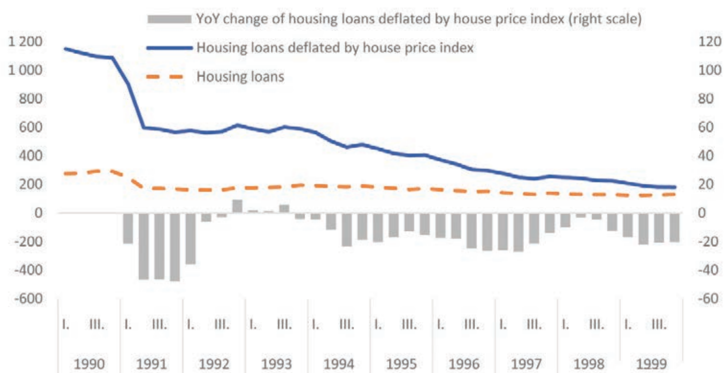
As a consequence of the phase-out of foreign exchange credits after the crisis, the outsourcing of credits and the number of housing construction decreased again. 2013 represented the lowest point, when just over 7 thousand flats were built in a year, and it was not until 2017 that the number of homes constructed every year rose above 10 thousand again.

3. The antecedents of the appearance of foreign exchange credits

3.1. The property market and lending environment following the change in the political and economic system

Following the change in the political system household income decreased and weak lending failed to support the demand side of the housing market. Consequently, compared to 1990, by the end of the decade the volume of housing loans had dropped substantially. It also played a role that subsidised housing loans provided by OTP (the biggest bank in Hungary) before the change in the political system were mass-redeemed at the beginning of 1991. In addition, the reduction of the volume of housing credits was the consequence of high interest rates – due to double-digit inflation –, which along with the uncertain income situation of households became a substantial obstacle to an increase in housing loans. (Figure 2.)

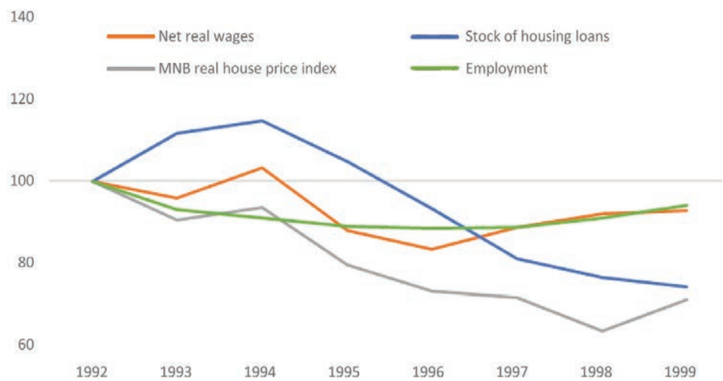
Figure 2: The volume of property loans and their year-on-year change in the 1990s (Billion HUF, and year/year, per cent)



Source: KSH

During most of the 1990s, as a consequence of the weak demand in the property market – due to lower housing credit volume, decreasing real wages and employment – housing prices decreased in real terms despite the fact that fewer new homes were being built (Fig. 3). Lower unemployment was explained by the fact that the participation rate was falling faster than employment, because after losing their jobs, many people left the labour market altogether.

Figure 3: The development of housing prices, net real wages, employment and housing loans (1992=100)



Source: KSH, MNB

3.2. The period of subsidized forint loans

Despite the low quality of housing, the demand for new homes was still weak at the end of the 1990s as a result of high interest rates and the uncertain income outlook of households. In this situation the Government attributed paramount importance to helping households to acquire suitable homes. It therefore changed its housing policy in 2000, by which it sought to achieve its goal by, on the one hand, promoting the construction of municipality rental flats, and on the other hand by subsidizing housing loans. We will discuss only the latter.

Two housing support programmes were launched: the interest rate support for credits financed by mortgage debenture (resource-side interest rate subsidy) and the supplemental interest rate subsidy (asset-side interest rate subsidy). The aim of the subsidies was to make the housing credits payable during a relatively short period, when interest rates and inflation were high. (Tárki, 2004)

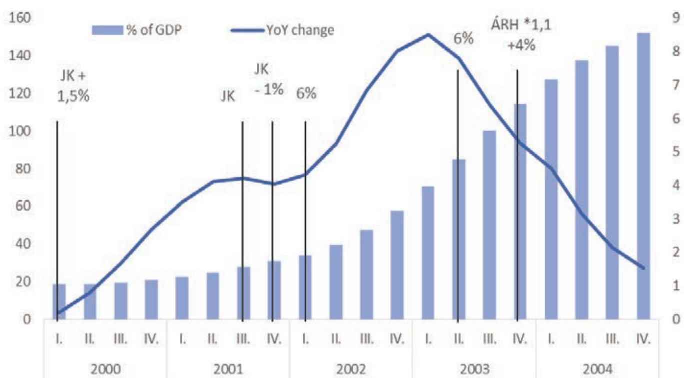
The essence of the asset-side interest rate subsidy is that part of the transaction interest rate charged by banks is paid from the budget, therefore the credit borrower is only burdened by the interest rate reduced by the subsidy. The size of the subsidy was linked to the reference yield of government securities, hence with the moderation of inflation and bond yields the amount of the subsidy also decreased. Since the measure did not bring the expected credit growth the subsidy was increased by 2 percentage points bringing down the maximum interest rate to be paid by the borrower to 6 per cent in autumn 2001. The subsidised loans could only be used to purchase or build new homes.

The resource-side subsidy was more important, as it could be utilized to purchase both new and used dwellings. The essence of this was that it provided an interest rate subsidy for the mortgage debentures, and therefore provided liquidity to the banks at a low cost. In January 2000, the subsidy was established at 3 percentage points, which was increased in several stages to the interest rate of the mortgage debenture plus 2 percentage points by February 2002. However, the subsidy could be a maximum of 10 percentage points. As a result of increasing the resource-side subsidy and maximizing the transaction interest that could be charged to the borrowers, the interest rate of subsidies loans decreased from 11.5 per cent to 6 per cent in two years. (Figure 4.)

In addition to subsidizing housing loans, personal income tax credit also grew considerably, and the tax credit was extended to the payment payable after credits used on used dwellings in addition to newly built ones.

The number of new housing loans – following the establishment of the upper limit of the transaction interest at 6 per cent in February 2002 – started to increase faster. After an HUF 153 billion increase in 2001, new lending amounted to HUF 493 billion in 2002, and the banks provided HUF 825 billion in housing loans the following year. The credit boom was promoted by the pent-up demand since the change in the political system, and the low credit volume before the boom.

Figure 4: The volume of household property credit (percentage)



Remark: the vertical lines and the numbers above them represent the rate of the maximum transaction interest and the date of modification, in the case of resource-side subsidies and the purchase of used homes (JK: Mortgage debenture interest rate, ÁRH: Government bond reference rate).

The proportion of housing loans compared to GDP rose from around 1 per cent in 2000 to 8 per cent by the end of 2003. At this time, the amount spent on the interest subsidy of housing loans exceeded 0.7 per cent of GDP. If the volume of HUF loans had continued to increase with the same dynamics as in the second half of the year and assuming the same subsidies as in early 2002, then by the end of 2008 the cost of the interest subsidy would have increased to an estimated 1.8 per cent of GDP.[3]

However, in addition to the increase in the subsidy amounts increasing interest rates and budget deficits also forced the Government to cut interest subsidies. In June and December 2003, the subsidies and the amount of assumable credit were both decreased. Due to the austerity measures carried out in 2003, the pace of HUF loan disbursement decreased and their volume started to decline in early 2006.

[3] Since the vast majority were resource-side subsidized loans within the beneficial credits, which could also be used for purchasing used housing (PAPP, 2005) we made our calculations using the interest rate conditions of this subsidy. The growth of the housing loan volume was almost entirely realized in the construction of state subsidies (SZALAY-TÓTH, 2003), hence we calculated that 100 per cent of the property loans disbursed in the quarter concerned were subsidized.

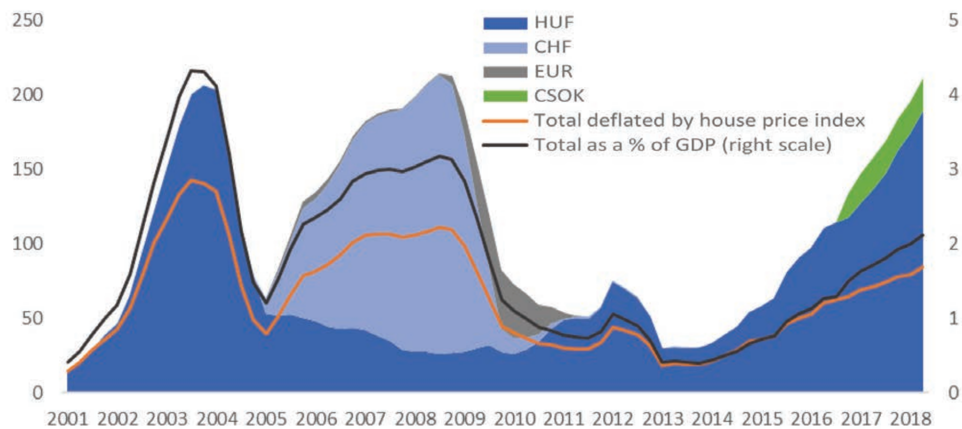
The long-term solution would have been to reduce inflation and make market housing loans accessible. The creators of the housing subsidy system were aware of this, since the basic idea of the system was to make housing loans affordable for a wider range of the population for a temporary period, until market interest rates would become lower with the reduction of inflation (Tárki, 2004). However, because of the high budget deficit and the shifting of the band of the forint's crawling peg in 2003, and because of the overall 600 basis points interest rate increase implemented partly as a consequence of this, achieving the aim of low interest rates became increasingly difficult to realise.

4. The period of foreign exchange credits

Due to the permanently high budget deficit and the partially powerless, partially faulty monetary policy, state subsidized loans became unsustainable. On the one hand, the high deficit limited the budget's room for manoeuvre, and on the other hand the deficit contributed to keeping inflation and interest rates at a high level. In parallel with the reduction in interest rates, the amount of interest subsidies would have decreased and after a while they would have been stopped. However, during the period prior to the elimination of the subsidy, not only did interest rates not decrease, but instead kept on increasing, since the base rate rose from 6.5 per cent in January 2003 to 12.5 per cent by the end of the year. This led to the fact that, due to the changes made in subsidies in December 2003, the high interest rates of property loans became unaffordable for many.

To maintain their profitability in this environment, the banks had developed a new product, the foreign exchange-based mortgage loans, which they started to offer to clients. The substantially lower interest rates seemed quite beneficial to clients, so the foreign exchange credits quickly became very popular. By 2005, they had taken over the role of HUF loans, thanks to which in the four years prior to 2008 a significant amount of foreign exchange credit was disbursed (Fig. 5).

Figure 5: New HUF and foreign exchange credits, and the CSOK (moving average of 4 quarters, billion HUF)



Source: KSH, MNB

4.1. The risks of foreign exchange lending

The boom in foreign exchange lending meant a fairly large risk, which in addition to the bank and the borrower involved in the transaction, also jeopardized the stability of the banking system and the real economy.

On the borrowers' side, one had to take into account the foreign exchange and the interest rate risk. With foreign exchange credits the banks shifted the entire foreign exchange risk to the borrowers, moreover, they could freely alter the spread (the difference between the buying and selling price of the foreign currency), which could further increase the borrowers' payment obligations. In the absence of proper regulations, the banks could also unilaterally change the interest rates, which they did during the crisis.

Despite the banks theoretically shifting the foreign exchange and interest rate risk to the borrowers, the foreign exchange credits still presented some risks for the banks as well. The value of the property offered to the banks as collateral could have fallen sharply, from which the borrowers were not able to pay their increased obligations – due to the exchange rate depreciation and the interest rate increase. The reason for this is that the properties sold by the banks in large numbers pushed the prices down on the market, which was also aggravated by the general economic downturn that was most likely felt at such times. Due to the reduced value of the property offered as collateral, the banks were not paid their claims and would suffer losses.

During the crisis, the way the banks reacted further increased the risks, since they reacted to the growing number of borrowers in default by increasing the interest rates and the foreign exchange spread. Consequently they shifted the losses stemming from the growing proportion of clients in default to those still solvent. However, this made keeping up with higher payments impossible for even more borrowers.

When there is a mass proliferation of foreign exchange credits the increasing payments also pose a risk to the national economy. Lower consumption due to the higher credit payments has a negative impact on GDP, which is further worsened by the consequently decreasing employment and wages. If a lot of households are not able to pay the banks in time as a result of higher payments, then due to the smaller risk-taking ability of the banks, credit supply is also moderated, which paired with a reduced credit demand due to the deteriorating income status of the population cuts down the disbursement of credits.

On top of that, the increasing proportion of non-performing loans – in the absence of adequate measures – can collapse the financial system, which would have caused a huge loss for the economy. In order to prevent the above, substantial budgetary resources might have been needed to re-capitalize the banks, which could have led to a sudden rise in the government debt. Unlike some other countries, Hungary managed to avoid this, partially because the financing of foreign owned banks was provided by their parent banks, and partially because the nationally owned OTP started its aggressive move on the foreign exchange credit market fairly late. Regardless of the above, three banks with domestic ownership received state subsidies in 2008 from the credit provided by the EU and the IMF: OTP Bank, FHB Bank and the Hungarian Development Bank (MFB). The aim of the financial aid was to assure market participants of the stability of these banks, by thus reducing their risk. Since the situation of these financial institutions remained stable, they have already repaid the subsidy.

A further risk is that as governments have to recapitalize banks, their debt also increases which results in a higher risk premia of government securities, therefore increasing the interest rate on government bonds and reducing their price. If the financial sector owns a substantial amount of government securities, due to declining bond prices it suffers a loss on those bonds. This potentially increases the capitalizing need of banks even further, which results in more national debt and even higher yield on the government securities. This in turn leads to a vicious circle, which mutually deteriorates the situation of the banks and the state budget. This risk did not impact the Hungarian banks, as they owned only a small amount of government securities, and due to the IMF credit, the government did not have to issue bonds for a while.

4.2. The period of the proliferation of foreign exchange denominated credits

Foreign exchange credits increased without a pause up until the crisis even though the risks were already known in the early stages. The Hungarian National Bank (the MNB) warned about the effect of increasing payment burdens due to the depreciation of the exchange rate from 2004, of which credit borrowers were generally not aware (MNB, 2004). In addition to the MNB the Hungarian Financial Supervisory Authority (PSZÁF) also issued warnings, however, neither of them had efficient tools based on legislation to slow down the disbursement of foreign exchange credits. They therefore primarily relied on informing the public and were obliged to trust the self-regulating mechanism of the banks.

The situation was exacerbated by the fact that there was lending competition between the banks in order to increase profits and market share, so lending conditions became easier during the boom period. The banks eased their requirements regarding the loan-to-value (LTV) ratio, the income-related expectations towards borrowers had also decreased, and the involvement of credit intermediaries working for commission also obviously pushed the consideration of risks into the background in favour of the short-term profit interests.

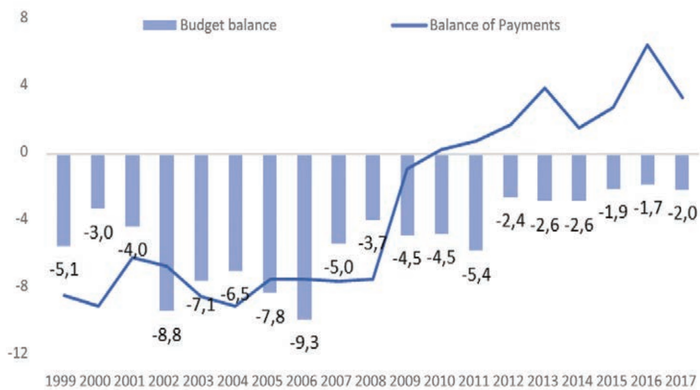
The agreement between the MNB and the Government in 2003 – as a result of which the base rate grew by 600 basis points in less than 6 months – may also have been responsible for the high interest rates on HUF loans, the consequently higher amount of interest rate subsidies, and therefore the proliferation of foreign exchange credits. Before this rapid increase in the base rate the MNB kept the base rate high despite the appreciation of the forint at the end of 2002, and intervened several times on the foreign exchange market to prevent the strengthening of the Hungarian currency. Then in the summer of 2003 the MNB – to the great surprise of the market – together with the Ministry of Finance announced the depreciation of the exchange rate band of the forint, by which they discredited the inflation targeting regime, since it was clear that the objective of the measure was not to maintain price stability, but rather to stimulate the economy. This unexpected measure by the MNB and the high budget deficit together led to the rapid depreciation of the forint, to which the MNB reacted by raising the base rate by 100 base points to 12.5 per cent on 11 June, 8 days later by 200 base points and by another 300 base points in November.

However, the greatest responsibility for the rapid proliferation of foreign exchange credits is held by the Government. On the one hand, increased deficit due to excessive fiscal loosening and high government debt can be blamed for the increased risk premium of HUF loans and for the high inflation, which also raised nominal rates. This was the reason why HUF loans lost their competitiveness against foreign exchange denominated credits. In this situation, the Government could have proactively regulated households' rate of indebtedness in foreign exchange, since only the government had the opportunity to bring in new legislation in order to intervene. However, they did not act, as the growth of foreign exchange credit substantially contributed to economic growth; therefore, its short-term limitation was not in their interest. The problem was worsened by the fact that as a result of the strict monetary policy, the forint was stuck at the powerful edge of the flotation band and the Government's communication – which despite several imbalances in the economy promised the fairly quick introduction of the euro – created the false illusion for households that in a few years the exchange rate risk of their foreign exchange credits would be substantially reduced.

However, in parallel with lending – partially in conjunction with and partially independent from it – other imbalances also formed in the economy, which later substantially exacerbated the effects of the global financial crisis. These were the considerable budgetary and external deficits, which were established in parallel with the increasing rate of foreign exchange credits (Fig. 6). The latter can also be associated with the credit boom to a significant degree. The balance of payment deficit in the early 2000s was primarily financed by non-debt generating FDI inflow. However, in the years that followed, the improvement in the income outlook of households and companies – partly in conjunction with the high budget deficit – promoted consumption beyond the actual incomes and investments beyond savings, which resulted in an increased BoP deficit. The shortfall was financed with foreign loans, the majority of which were channelled by the banks in the form of foreign exchange credits to the market participants.

In contrast, the increased budget deficit was caused by the loose fiscal policy involving most items in the budget, which included transfers to households, the reduction of taxes and one-off expenditures (mainly motorway construction) and subsequently increasing debt and interest expenses.[4] The amount of the deficit became especially notable from 2002, when it rose to almost 9 per cent of GDP and the high deficit was sustained until an adjustment made due to the effects of the global financial crisis. With the considerable external and internal imbalance, the economy started to over-heat in 2005 and was characterized by obvious capacity limits by 2006 (MNB, 2018).

Figure 6: Budgetary position in the ratio of GDP (percentages)



Source: KSH, MNB

[4] OHSORGE-ROMHÁNYI, 2007

4.3. Rebalancing of the economy

It was already clear before the crisis that the twin deficit was unsustainable, so the government had to start fiscal consolidation. Without it the market would have eventually forced a rebalancing. Although in 2007 the budgetary deficit was somewhat reduced, there was no comprehensive and considerable adjustment before the crisis, so the market forced it in the end. The crisis – in accordance with the scenario that can be anticipated based on previous experience – triggered the growth of interest rate premia on domestic assets which resulted in the substantial depreciation of the forint and increasing yields. The depreciation of the exchange rate helped to reinstate the external balance by reducing internal demand. This however caused a substantial real economic sacrifice, which was worsened by the high foreign exchange debt. On the one hand, household consumption was negatively impacted by growing monthly payments on loans and higher inflation due to the exchange rate depreciation. These negative effects were further exacerbated by decreasing employment and the reduced real value of government transfers. On top of that, a great many companies were also indebted in foreign exchange, so the depreciation of the exchange rate impacted them negatively too, which reduced their output and investment expenditures. The reduced income of the private sector and the growing uncertainty hindered the demand for credit, due to which both the corporate and household sectors turned into net lenders. Thirdly, the abundant external financing opportunities which were in abundance for banks before the crisis also disappeared, and the increasing non-performing loan (NPL) ratio deteriorated the capital position of banks, which also reduced the credit supply. Lastly, the cost of financing government debt also increased due to the high proportion of foreign exchange debt within the government debt and growing interest rates. Because of the substantial reduction of consumption and investment expenditure by the private sector, imports fell significantly, which substantially improved the external balance.

Besides the above, an external factor also contributed to the rebalancing of the economy, namely that in the EU budgetary cycle between 2007 and 2013 the transfers to Hungary from the EU increased considerably, which had a beneficial impact on the external financing position of the country. The moderation of the profit and profit transfers of foreign-owned companies also helped to reinstate the external balance. Compared to the region, the recession in Hungary was worsened by the fact that while at the beginning of the crisis the fall in external demand in the other countries of the region was paired with high government demand, external and internal demand fell simultaneously in Hungary from as early as 2007 due to the tightening of the budget.

4.4. The necessity to solve the foreign exchange credit problem

Despite the adjustment of the imbalances in the BoP and the budget, the foreign exchange credit problem would have held back economic growth in the long-run in any case if it had not been dealt with in a proper way, therefore the situation had to be addressed. The reason why foreign exchange credits held back growth is that a weak HUF exchange rate in the long run risked lowering household consumption for one or two decades due to the high burden on households' balance sheets in respect to credit. Moreover, uncertainty related to the exchange rate forced foreign exchange credit borrowers to build additional reserves, so the high savings rate lowers demand from the private sector even more. Low demand reduced the growth of employment and wages, which as a second round effect made it even more difficult for households to cover monthly credit payment obligations, increases new credit disbursement and hindered the economy's recovery from the crisis.

Another problem is that foreign exchange credits also restrict the room for manoeuvre in monetary policy. This is underlined by the fact that in order to offset the setback of external demand during the crisis, the interest rates should have been reduced, however, in October 2008 the MNB had to hike the base rate by 300 basis points to protect the forint. The excessive depreciation of the forint would have further heightened the payment burdens of households, enterprises and the Government, which all became indebted in foreign exchange, and would have increased the HUF value of the foreign exchange debtors' debt. Moreover, during the economic recession, not only was the reduction of the interest rate risky due to the foreign exchange credits, but the efficiency of the monetary policy was also reduced. The stimulating effect of an interest rate cut would have been tamed by the fact that due to the depreciation of the forint, the demand by those with foreign exchange credits would have decreased, while the credit supplying ability of banks would have also deteriorated due to the foreign exchange receivables in their balance, i.e. the weakening of monetary transmission.

It has already been noted that foreign exchange credits caused significant losses not only to households, but also to the banks. Due to the increasing NPL ratio, the banks' revenues decreased, and they had to build reserves for potential losses stemming from NPLs, which tied up the majority of their capital. Consequently, the banks were not able to take further risks without substantial recapitalization, therefore credit supply fell, which made the economy's setback even more severe. Bank lending can be stimulated in several ways, including making borrowers solvent again and clearing the banks' balance sheets from bad assets, to which the settlement of the foreign exchange credit problem contributed to a great extent.

The negative effect of the crisis on the property market must be noted. The sudden collapse of lending and the economic downturn significantly lowered the number of newly built dwellings, and consequently the annual renewal rate of the housing stock too (Fig. 7), which even in 2018 did not reach the level before the crisis, and was still extremely low by international comparison. However, without solving the foreign exchange credit problem, the revival of lending in recent years could also not have got underway, and the increase in housing construction would have been even slower.

Figure 7: The number of new dwellings and the annual renewal rate of the housing stock (Thousand pieces and per cent)

Source: KSH

Despite the settlement of the foreign exchange credit problem, the weak economic environment that lasted for several years negatively impacted construction as well. Since government and private investments fell alongside the housing market demand, the output of the construction industry was reduced by 30 per cent between 2005 and 2010. Due to the downturn of construction capacities deteriorated as well, which was also reflected in the migration of labour. The replacement of deteriorating capacities during an extended crisis takes longer and requires more effort, than after a temporary recession: it is more difficult for example to attract back workers who have gone abroad than those who have stayed in the country during a temporary recession. Therefore, because of the crisis the potential output of the construction sector also presumably decreased, which contributed to the capacity limit that can be experienced currently.

4.5. Measures taken to address the foreign exchange credit problem

In order to prevent long-term negative effects, the Government had to find a solution for the problem created by the foreign exchange credits. As a first step, it basically made the disbursement of new foreign exchange credits impossible by tightening the regulations, then in order to moderate the burden on borrowers it made the application of the central exchange rate for redemption obligatory (the bank's central exchange rate, in absence of that of the MNB). Furthermore, the Government entered into an agreement with the Hungarian Banking Association in December 2011 and among other things enabled non-performing borrowers to convert their credit to a more favourable forint loan, which, however, fairly few people utilized at the time.

To mitigate the problem of foreign exchange credit borrowers, the Government introduced several other measures. On the one hand, it provided the option of early repayment, under which nearly 170 thousand borrowers' HUF 370 billion debt was written off. The benefit was due to the fact that, for example, Swiss franc loans could be paid back by early repayment at an exchange rate of HUF 180 instead of the approx. HUF 250 market rate of the time. 30 per cent of the losses derived from this could be deducted by the banks from the bank tax. On the other hand, an exchange rate cap was introduced to subdue the impact of exchange rate fluctuation, which also included written off debt (the interest obligation over the fixed exchange rate was eliminated, half of which was born by the government and half by the banks, but the banks were able to deduct it during the process of financial accountability). By the end of 2014, 186 thousand foreign exchange credit borrowers had signed such an agreement. Thirdly, the borrowers who were forced into the most difficult situations were protected by the Government's extraordinary dislodgement moratorium effective until 16 September 2015 to prevent them from ending up on the streets. Fourthly, the National Asset Management still represented a solution for insolvent foreign exchange and forint borrowers. The Asset Management purchases the properties of insolvent borrowers, so families can stay in their homes by paying a discounted rent. More than 40 thousand properties were offered to the National Asset Management by the end of February 2017, so it provided housing for roughly 150 thousand people. According to the agreement signed with the EBRD the amount of housing purchased under the programme was extended by 10 thousand, and was expected to reach 35 thousand by 2018.

Despite the numerous measures supporting borrowers, it had become obvious by 2014 that the economic leadership had to find a solution that would be able to solve the problem once and for all by phasing out the foreign exchange credits that were shackling both households and the economy. At the same time, the conversion into forints could only be considered under a healthier banking system, stable macroeconomic fundamentals and in a lower interest rate environment than the one that was in effect upon borrowing the credit, since the incorrectly timed settlement and phase-out might very well have been damaging to the economy.

The turning point was represented, on the one hand, by the decisions of the Constitutional Court as of 28 February and 24 March 2014. Based on the joint interpretation of these two decisions, in the case of family housing being endangered and credit institutions abusing their dominant power, Parliament was empowered to exceptionally alter the content of bilateral civil agreements. On the other hand, the European Court passed a resolution on 30 April 2014 allowing Hungarian courts to examine the unfairness of the foreign exchange credit agreements. Afterwards, in its decision of 16 June 2014, the Curia stipulated that the exchange rate gap was unfair in all foreign exchange credit agreements, and established that the contract modifications of retail loans – until they were proven otherwise – did not satisfy the legal provisions.

Based on the legal regulations accepted after the decision of the Curia, in March–April 2015 the banks had to reach a settlement with their clients who had borrowed foreign exchange credits on the unfair exchange rate gap, and arrange the reimbursement of overpayments due to the unilateral contract modifications with each client. Some two million current and ex-debtors received settlement letters from their banks. The debt of Hungarian families was mitigated by a total HUF 734 billion, and their payments were reduced by an average 20–25 per cent (HUF 20 thousand/month).

Hence the conversion of the substantially reduced foreign exchange credit volume could be handled by the MNB. The only possible option for such a conversion amount was the utilization of the foreign exchange reserves. The adequacy of this solution was eventually also justified by market reactions.

Based on the act passed by Parliament on 25 November 2014,[5] the conversion of housing and untied mortgage credits into forints took place in early 2015. The conversion was made at the market exchange rate, considering that based on the decision of the Curia the exchange rate risk was the fundamental feature of the foreign exchange credits, therefore it burdened the client. The conversion rate was the lower value between the market rate of 7 November 2014, or the average of the official MNB rates between the announcement of the Curia and 7 November. In the case of the Swiss franc it was HUF/CHF 256.47 (period average), and in case of the Euro HUF/EUR 308.97 (the rate as of 7 November).

The conversion into forints technically took place simultaneously with the reimbursements, but the exchange rate of foreign exchange credits was already fixed on 1 December 2014 at the pre-defined levels. 50 per cent of household credits, some HUF 4,100 billion were foreign exchange credits at the end of 2014. Following the conversion of mortgage loans into forints their ratio fell below 7 per cent so they amounted to only HUF 500 billion. Considering that the amount of reimbursements did not have to be converted, roughly HUF 3,000 billion was needed to convert the retail mortgage loans into forints (approx. EUR 10 billion).

[5] Act LXXVII of 2014

The beneficial effects of the conversion of mortgage loans into forints were already tangible in the short-term: thanks to the exchange rate being fixed at the end of December 2014, which was the "antechamber" of the conversion, the drastic depreciation of the forint against the Swiss francs in mid-January 2015 did not increase the burden on borrowers and the risks of banks any further. Consequently, the previously substantial national economic risks related to retail credits could not be realized. At the same time, for example, Croatia and Poland were not in such a beneficial situation. In these countries indebtedness in foreign exchange, mainly in Swiss francs, was also causing major problems, but the settlement of the foreign exchange for borrowers was not at such a progressive stage as it was in Hungary. The borrowers in Swiss francs had to repay 15 per cent more in Croatia and nearly 10 per cent more than a year before, due to the strengthening of the Swiss franc. In Hungary, a debt increase of some HUF 400 billion would have been caused for households if the conversion into forints had not taken place, which would have meant payments of 10 per cent higher on average.

However, the foreign exchange credits other than mortgage loans continued to carry an exchange rate risk. The appreciation of the Swiss franc in January 2015 resulted in increased burdens for borrowers with foreign exchange-based consumption credit. Following the conversion of foreign exchange mortgages into forint, the Government looked for a solution for the conversion of the remaining vehicle and consumer loans into forint as well. Although the volume of these loans (HUF 305 billion) was considerably lower than the volume of mortgages, considering that the number of these contracts exceeded 240 thousand it impacted a substantial number of households.

Parliament passed the act regulating the conversion of foreign exchange vehicle and consumer credits on 22 September 2015.[6] Based on the Act, the conversion into forints took place on the effective market exchange rate from 19 August 2015. However, it was also established that the almost HUF 31 billion debt caused by the difference between the exchange rates applied for the mortgage loans in November 2014 (256.47 HUF/CHF) and in August 2015 (287.22 HUF/CHF) would be assumed by the banks and the government from clients at 50–50 per cent. (The banks could deduct the expenses due from their tax obligations.) In the case of Swiss franc loans, the measure meant a payment reduction of 10–11 per cent. For a client with an average Swiss franc vehicle credit, the capital part of the debt was reduced by some HUF 318 thousand.

With the conversion of personal and vehicle credits into forints, the retail foreign exchange credits were completely phased out in Hungary. In 2009, the ratio of foreign exchange credits was still 71 per cent in the entire retail credit volume, and by the end of 2016 it was reduced to 1 per cent.

Based on the impact of Government measures since 2010, the population's debt was reduced by a total of HUF 1,400 billion, a part of which was financed by the banks, and the other part by the budget (early repayment: HUF 370 billion, accountability: HUF 734 billion, debt relief due to NET purchases: HUF 270 billion, second conversion into forints: HUF 30 billion, exchange rate cap and state interest subsidy: HUF 20 billion). Furthermore, thanks to the "fair bank" act the interest rate risk was significantly moderated, since the interest rate of loans was not permitted to increase without a reason.

6 Act CXLV of 2015

5. Comparison of the credit boom before the crisis and now

The credit cycle before the crisis was characterized by high forint interest rates due to sizeable inflation and a strict monetary policy. It prevented households from taking large volume HUF loans at market interest rates, so the alternative was provided by subsidized loans and foreign exchange credits. In contrast, the low external inflation environment in the current cycle, and the consequently loose monetary policy paved the way for unsubsidized HUF loans at market rates. In this sense, the current boom of lending brings less risk, as it does not burden the budget and foreign exchange rate fluctuations are not hazardous either. Furthermore, in 2013, the MNB received legal authorization to create an act on regulating the disbursement of credits, therefore it is not only able to influence the credit market through proposals, but also through regulations.

Using the available tools – e.g. by deepening the mortgage market and reducing the long-term interest rates –, the MNB can support borrowers with favourable conditions when they take out credit. Additionally, by creating the so-called debt brake regulations it guarantees that even in cases when interest rates increase, borrowers do not get into trouble with their payments. Thanks to the above, the macro-prudential tools of the MNB will most likely be able to prevent the next crisis coming from the financial sector (see the box).

Box: The MNB's tools to support healthy lending

Partly to restart lending, from 2012 the MNB substantially eased its monetary policy: first it reduced the base interest, and later it restructured the available toolset (reduction of reserve requirements, restructuring of the priority tool/asset), and finally launched various new programmes (including: the Credit for Growth Programme, MNB swap tenders providing HUF liquidity, interest rate swap tenders with monetary policy purposes, and the Mortgage Buying Programme). However, it is important to note that the MNB did not try to promote the irresponsible disbursement of credits, and defined numerous measures to prevent a repeat of the risky lending of the 2000s.

The MNB made advances in two key areas in order to foster sustainable retail lending. On the one hand, new loans could only be disbursed under certain conditions as a result of the so-called debt brake regulations, on the other hand it launched programmes, which made credit with long interest rate periods, i.e. 5 years or longer cheaper for the banks, thus promoting more stable payments.

Debt brake regulations

According to the MNB Decree No. 32/2014. (10. IX.) (hereinafter referred to as: Decree) new loans could only be disbursed if the currently effective regulations regarding the debt-to-income and loan-to-value ratios were met.

According to the debt-to-income ratio (hereinafter referred to as: DTI) the payment may not exceed the defined percentage of the certifiable income. Hence, the DTI substantially reduces the indebtedness of clients and defines separate regulations for non-forint or foreign exchange or foreign exchange-based credits, which are a lot lower than the values applicable for HUF loans, thus compensating the risk of foreign exchange credits. In addition, from 1 October 2018, the DTI considers the length of the credits' interest period, which motivates households to take credits with more reliable payments. From this date on, the maximum debt-to-income redemption for credits with shorter duration decreased, while it was unchanged in the case of credits with a longer duration.

Table 1: The maximum ratio of credit payments to income (per cent)

Gross monthly income	*Denomination*	*Less than 5 years*	*Between 5 and 10 years*	*Over 10 years, or fixed to the end of the duration*
Under HUF 400 thousand (HUF 500 thousand from 1 July 2019)	*Forints*	25	35	50
	Euro or Euro-based	15	25	
	Other foreign exchange or foreign exchange-based	5	10	
Over HUF 400 thousand (HUF 500 thousand from 1 July 2019)	*Forints*	30	40	60
	Euro or Euro-based	20	30	
	Other foreign exchange or foreign exchange-based	10	15	

The other index introduced by the Decree is the **loan-to-value ratio** (hereinafter referred to as: LTV), which limits the amount of credit to a certain proportion of the collateral.

In the case of the most frequent HUF mortgage credits, the amount of the credit may not be more than 80 per cent of the collateral, however the regulation here also considers in which foreign exchange the amount was disbursed, and separate conditions apply to financial leasing and vehicle financing.

Table 2: Maximum disbursement by property or vehicle coverage in the ratio of the collateral value (per cent)

Denomination	*Property collateral*		*Vehicle collateral*	
	Credit	*Financial leasing*	*Credit*	*Financial leasing*
Forints	80	85	75	80
Euro or Euro-based	50	55	45	50
Other foreign exchange or foreign exchange-based	35	40	30	35

It is important to note, that **debt brake regulations also have their limits,** as such situations might arise when this precaution does not help either. For instance, the LTV might also prove insufficient during a long-term property price depreciation period, as the debt might exceed the value of the property, by reducing the willingness to pay the monthly payments. The income of a borrower might quickly fall to zero in the case of a labour market shock, which can make the borrower non-performing. An imbalance similar to the crisis of 2008 might simultaneously reduce the price of property and cause major unemployment. The debt brake regulations may not provide protection in all situations, but it can be expected that they will mean proper reserves for the majority of borrowers and banks during an unexpected shock.

Increasing the ratio of credits with a long interest rate duration

Thanks to the low proportion of retail foreign exchange credits, they will almost certainly not cause any difficulties for households or the banking system in the near term. However, due to the high proportion of credits with variable interest – especially in the currently growing interest rate environment – they may cause substantial risks. Therefore, the MNB introduced incentive measures both on the credit supply and credit demand sides to reduce the price of credits with long-term fixed interest rates.

At the end of 2017, to facilitate the long-term fixing of the low interest rate environment, the MNB decided to introduce a **monetary policy-based interest rate swap** with 5 and 10 years duration, paying variable interest rates (hereinafter referred to as: MIRS). The aim of the MIRS was to flatten the yield-curve and make the low interest rate environment of short-term securities visible in long-term securities as well. The MNB made MIRS interest rate swap transactions to the value of HUF 300 billion on a quarterly basis. The programme promoted the interest rate reduction of long-term government bonds, retail and corporate fixed loans. Under the MIRS, the MNB paid 6 months' BUBOR to the credit institutions, and the credit institutions paid fixed interest rates to the MNB. In September 2018 the MNB decided on the gradual phase-out of the programme, with the last tender being held in December 2018.

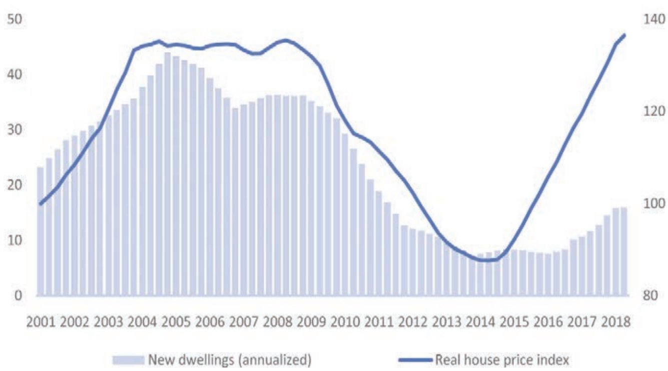
In addition to the above, for more than a year from the end of 2017, the MNB pursued a **mortgage debenture-buying programme**, within the framework of which it purchased securities up to 50 per cent of the Hungarian mortgage debenture stock. The primary aim of the MNB's programme was to help credit institutions increase their interest rate periods on mortgage loans.

Overall, the MIRS and the mortgage-buying programme achieved its goals: the interest rates of long-term fixed loans considerably declined and the mortgage debentures market grew.

To achieve an easier comparison of credits with longer interest periods, the MNB established the **Certified Consumer-Friendly Housing Loan** label in 2017. Those HUF based housing loans can be offered under this label, in which the amount of interest rates, expenditures, and the duration of credit assessment and disbursement do not exceed the limit defined by the MNB and the loan's interest period is at least three years. In addition to the above, the MNB created a website, where certified housing loans can be compared, making the selection easier, and thus making the competition fiercer on the mortgage market. Nowadays, almost two-thirds of newly disbursed mortgages with an interest period in excess of 3 years are Certified Consumer-Friendly Housing Loans.

Currently, the biggest risk is represented by the capacity constraints in the construction sector because of strong demand which pushed up prices. The credit boom before the crisis and also this time led to increasing house prices. However, in the early 2000s, following the termination of subsidized forint loans, property prices did not increase any further in real terms during the disbursement of foreign exchange credits. This was probably due to the fact that growing demand was matched by a growing number of housing constructions. In the current credit cycle, increasing credit disbursement is accompanied by rising property prices, but it is questionable whether the rise in prices will stop when both household income and the volume of credit are rising. This is because after the crisis housing construction fell to an all-time low, and it would have been from here that a significant increase would be needed to provide sufficient housing supply to stop the increase in prices. (Figure 8.)

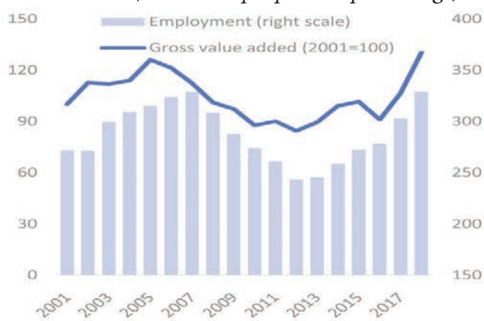
Figure 8: The development of housing construction and house prices (Thousand pieces and 2001 Q1=100)



Source: KSH, MNB

The expansion of the housing supply, however, is limited by construction capacities, which can also be observed in labour and raw material shortages. In 2013, in parallel with the increasing performance of construction, the number of people in work also started to rise, so by the first half of 2018 it had reached its peak before the crisis (Fig. 9). The limitations of further growth are indicated by the rapid growth of the vacancy rate, which is now at an all-time high, and also the dynamic increase in real wages (Fig. 10). In the meantime, the per capita value added per construction employee approached the level prior to the crisis. Although by regional comparison there is room for improvement, it is likely that without a serious structural reconstruction, there will be no significant efficiency reserves in the sector. Besides private sector demand, public investments tie up construction capacities, which is partially fuelled by the amount of EU transfers, but projects financed from the national budget also represent a substantial portion.

Figure 9: Employment and value added in Construction (Thousand people and percentage)



Source: KSH

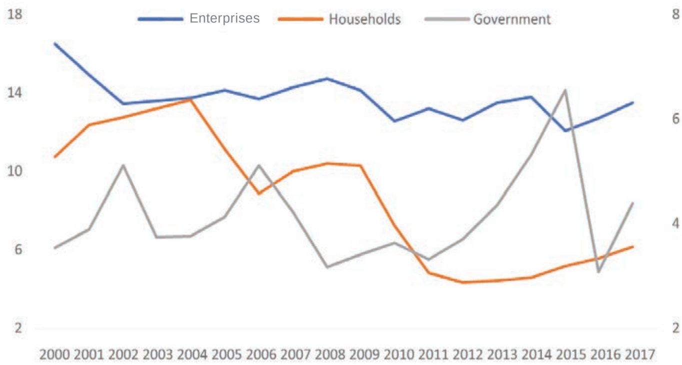
Figure 10: Vacancy ratio and real wages in construction (percentage)

Source: KSH

The budget deficit is currently lower than during the previous credit cycle. While between 2004 and 2007 the deficit was 7.2 per cent on average, between 2012 and 2017 it was reduced to 2.2 per cent. The difference between the two periods, however, is a lot smaller if we consider the amount of resources received from the European Union, which was 1 per cent of GDP in the previous period and 3.9 per cent in the latter. With corrections made for this difference, the current budget balance corresponds to a 5.1 per cent (=2.2 + 3.9 – 1) deficit, which means considerable demand from the fiscal side.

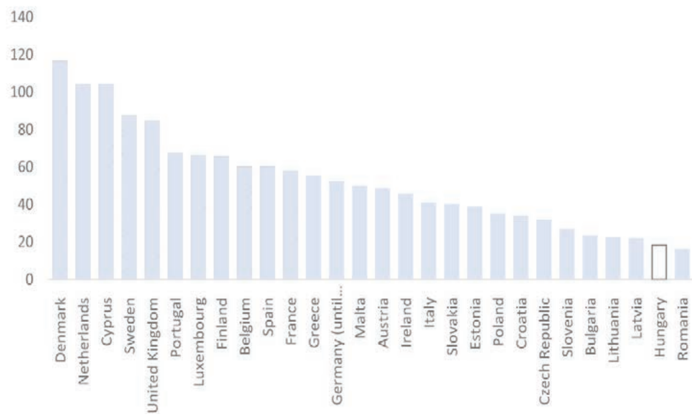
Following the decline of public investments financed by EU transfers in 2016, they started to grow again and this tendency will continue in parallel with the increase in incoming EU transfers. In the meantime, household and corporate investments, which were at a historical low even by regional comparison a few years ago, started to increase (Fig. 11). Given the favourable household income and the high volume of credit disbursement, the growing construction demand may continue. This is supported by the fact that there is room to increase the housing credit volume of households, since the credit-to-GDP ratio is low both historically and by international comparison (Fig. 12). Therefore, demand seems to be demonstrating recovery in all three sectors at the same time.

Figure 11: Gross fixed capital formation as a share of GDP (percentage)



Source: KSH

Figure 12: Household debt-to-GDP ratio by international comparison (percentages)



Source: KSH

The bottlenecks created on the supply side however limit further growth. The increasing costs due to the labour shortage can already be seen in the increasing housing prices. Based on the survey by the MNB taken among market players, the most important limiting factors are the labour shortage in construction, the crowding out effect of state projects, and the uncertainty around the discounted VAT rate of new housing (MNB, 2018b). The price increase could be moderated if demand increases more gradually over a longer time period, as then the supply side would more likely be able to adapt. On the other hand, the disintegration of construction capacities can be prevented if governmental investments are realized in the period when demand from the private sector is lower. To even out the fluctuations of demand, it might be helpful to delay non-productive governmental investment, which does not promote the extension of the supply side capacities, in the current situation when the private sector's activity is brisk.

Due to the simultaneously high private and public demand, the economy will soon become overheated, making it necessary to tighten monetary policy sooner. The rising interest rates impact the budgetary position unfavourably due to the high national debt-to-GDP ratio and decelerating economic growth. To prepare for that, it would be practical to moderate the budget deficit and the national debt in the current situation so that the government is not forced to apply austerity measures nor a higher interest rate environment. Lower debt will reduce the cost of debt financing through both the lower amount of debt and risk premia now and in the coming years. It is also important, that from a lower debt level there will be room to increase the debt level later if necessary.

6. Summary

The previous boom of lending was accompanied by notable imbalances. The introduction of subsidized HUF loans was justified by high inflation and the permanently low level of housing construction. This system could have been justifiable, however, if it is in effect for a temporary period until inflation and interest rates were moderated. However, this had been impossible due to the continuously high budget deficit in the 2000s and the excessive consumption financed from foreign credit. Under such circumstances when subsidised HUF loans were phased out, they were soon replaced by foreign exchange credits. These substantially increased the already existing imbalances in the economy and heightened the shock to the economy during the crisis. The hardships were made even worse by the fact that foreign exchange credits reduced the monetary policy's ability to moderate the consequences of the crisis. In the absence of proper problem management, foreign exchange credits could have slowed down economic growth for a long time through the low credit supply of the banks.

Compared to the previous credit cycles, the currently low short- and long-term interest rates, as well as the proper regulation guarantees that households can finance their housing purchases with market-based HUF loans at an acceptable level of risk. Consequently, the situation on the financial side is more reassuring than before. The risk of the current period is caused by the fact that, due to the bottlenecks emerging in construction, the housing supply is not able to keep up with the elevated demand due to the population's improving income situation, despite the possible moderation of the latter by regulating the credit outflow. Excess demand is increased by the substantial government investments that are stretching construction capacities in addition to the investments in the private sector. Tight supply leads to rising property prices, which on the one hand stimulates speculative purchases, and on the other hand makes the purchases by people searching for real housing purposes increasingly expensive. An additional risk is that if the currently high external demand decreases, the income of households will also decline, therefore in this situation the budget should temporarily increase demand, but it will only have a limited opportunity to do that, given the high debt level. To prevent the above problems, it would be advisable to reduce the budget deficit and the national debt in the currently favourable environment.

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INCREASED FOCUS ON FINANCIAL CONSUMER PROTECTION IN STRESSFUL SITUATIONS CAUSED BY FOREIGN CURRENCY LOANS

Introduction

Shortcomings in financial consumer protection were identified by experts as one of the root causes of the 2008 economic crisis. The intense development of financial consumer protection began after the crisis, so it is not only a key priority for Hungary, but also a new challenge for the European Union. Hungarian governments were also under pressure to find an optimal solution for foreign currency loan contracts, which put hundreds of thousands of Hungarian households in a near-bankrupt situation.

In 2011, a Risk Report by the Hungarian Financial Supervisory Authority stated the following: *"From 2003, foreign currency loans and loans denominated in foreign currencies started to become increasingly widespread: By 2011, 55% of the assets of banks and 70% of residential real estate mortgage loans were foreign exchange assets, denominated in Swiss francs for the majority of residential real estate mortgage loans. After the crisis, partly due to the loss of jobs and partly due to the weakening of the HUF exchange rate, an increasing number of debtors were unable to pay their monthly instalments."*

I divided the state measures aiming to support foreign currency borrowers into three groups:

- The nature of measures specifically aimed at supporting foreign currency borrowers in a difficult situation became more and more direct in parallel with the worsening of the situation, which is clearly demonstrated by the fact that, while the first step in 2008 was "only" an agreement with major banks in Hungary to provide relief to struggling debtors and act more flexibly when evaluating their needs, after 2011 the methods of HUF conversion were already prescribed by law.
- Another group was constituted by consumer protection measures and laws aiming to regulate the banking sector so that banks should provide adequate information to consumers about the risks associated with loans and the characteristics of the loans offered.
- The third group includes measures for the improvement of people's financial literacy. Without such measures, regulations regarding the obligation of the banking sector to provide appropriate information would, in many cases, be insufficient in themselves because households should be enabled to assess the risks associated with loans and make more sound financial decisions than before.

In my study, I will analyse the financial consumer protection measures taken by the Hungarian government between 2009 and 2017. My analysis also examines the extent to which such measures contributed to the support of foreign currency borrowers in a difficult situation.

1. The main causes of the emergence of foreign currency lending in Hungary and the development of the crisis situation

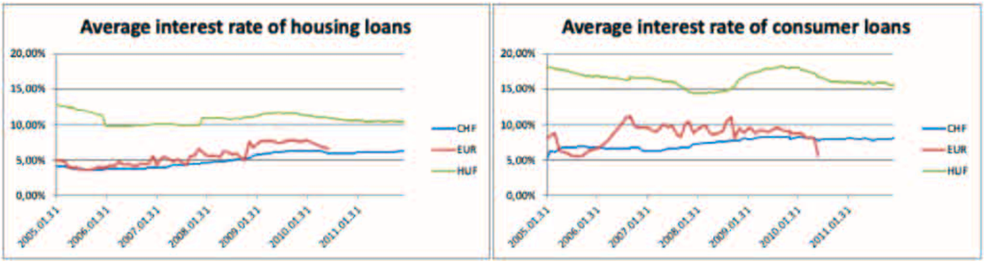
In Hungary, foreign currency lending started to grow at an increasing pace after 2003. Foreign currency loans as loan products provided by banks, however, appeared already in the early 2000s, initially mainly in the field of motor vehicle financing.

The foreign currency-denominated financing of housing loans started to become popular after 2004. One of the identified root causes thereof was the abolition of state support for housing loans.

Besides the abolition of state support, another major reason identified in relevant literature was that the interest rates in foreign currency financing were a lot more favourable (compared to HUF loans).[1]

Figure 1 shows the development of the average interest rates of HUF-, euro- and Swiss franc-denominated housing and consumer loans:[2]

Figure 1: The development of the interest rates of HUF and foreign currency loans[3] [4]



The price advantage of foreign currency loans against HUF loans is clearly visible for both housing loans and consumer loans. While the average interest rate of HUF-denominated housing loans was consistently above 10% in the period concerned, Swiss franc- and euro-denominated housing loan interest rates, with the exception of 2009, were approx. 5% to 6% and rather even lower. The difference is even more spectacular in the case of consumer loans.

With the spread of foreign currency loans and loans denominated in foreign currencies, the population were increasingly exposed to changes in exchange rates, and, because households did not typically realise their income in foreign currencies, even a slight increase in exchange rates resulted in significant additional burden on them.

The rise in foreign currency lending, which was characterised by lower interest rates than HUF loans, was also a consequence of the low level of financial literacy and risk awareness of the population. Decisions on the currency of a loan were made mostly on the basis of interest rates and monthly instalments, and the risks associated with exchange rate fluctuations were often not taken into account. The increase in the volume of foreign currency loans was also partly caused by the fact that some households would not even have been creditworthy for a HUF loan due to their low income as compared to the higher HUF instalments, so the only option for them was foreign currency-denominated financing.

Figure 2 shows the development of the volume of residential HUF and foreign currency loans and the ratio of foreign currency loans:[5]

1 T. BALÁS - M. NAGY: *A devizahitelek átváltása forinthitelekre*. Hitelintézeti Szemle, Budapest, 2010/5. sz. 416-430.

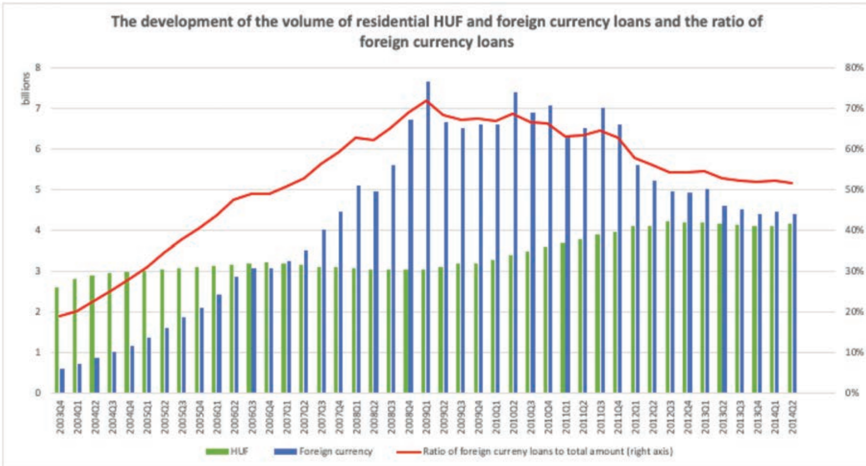
2 Edited internally using statistical data from the website of the National Bank of Hungary.

3 For a long time, experts were careful about Japanese yen-denominated lending due to the unpredictability and vulnerability of the yen exchange rate. Although in 2007, several credit institutions already offered Japanese yen loans, according to a survey by hitelnet.hu in 2013, *"approximately one in 25 foreign currency borrowers requested Japanese yen-denominated loan financing"*. Considering the fact that, on the one hand, no database was available on the development of the interest rates of Japanese yen-denominated loans and, on the other hand, a comparison of the development of EUR and CHF interest rates with HUF interest rates is sufficient to understand the reasons for the spread of foreign currency lending, this study will not present yen interest rates. https://hitelnet.hu/jelzaloghitel/hogyan-fizetik-torleszteseiket-most-a-jenhitelesek

4 The volume of EUR-denominated loans declined significantly after 30 June 2010; therefore, fluctuations in the available interest rate databases are so high in terms of average interest that the data could no longer be interpreted. For this reason, the graphs show the EUR interest rates only until 30 June 2010.

5 Edited internally using statistical data from the website of the National Bank of Hungary.

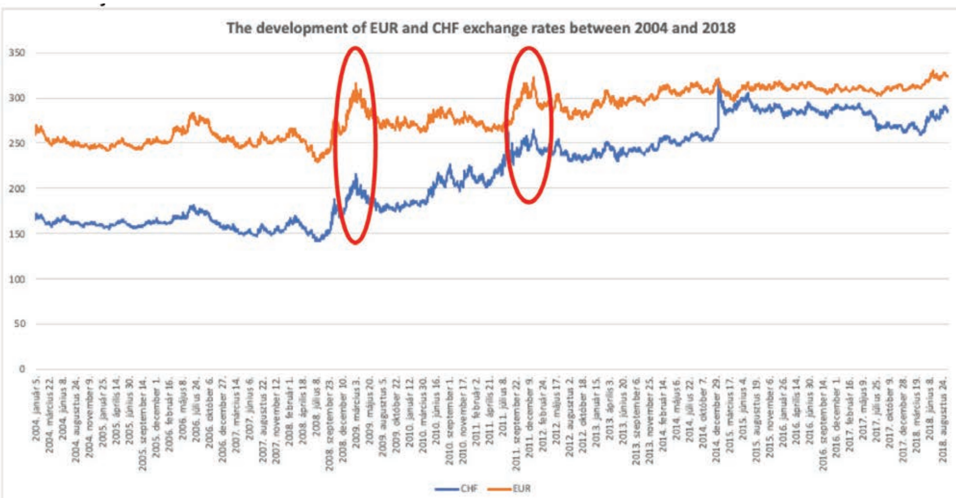
Figure 2: The development of the volume of residential HUF and foreign currency loans and the ratio of foreign currency loans



In 2008, the volume of residential foreign currency loans increased to over HUF 7,000 billion from HUF 600 billion in 2003, meaning that 70% of the total amount of loans was exposed to exchange rate fluctuations.

Figure 3 shows the development of the exchange rates of euro and Swiss franc:[6]

Figure 3: The development of EUR and CHF exchange rates



[6] Edited internally using statistical data from the website of the National Bank of Hungary.

The first critical situation where state intervention was already inevitable arose at the end of 2008. At that time, the all-time high in the volume of foreign currency loans was accompanied by a situation in which the EUR exchange rate came close to, while the CHF exchange rate exceeded, the highest level of the previous five years. Although exchange rates temporarily dropped afterwards, they started to grow again in the third quarter of 2009. The fact that the volume of foreign currency loans did not increase between 2009 and the end of 2011 (there was even a slight fall) was already due to a shift to HUF loans. This was due partly to the first measures of the government (state) to support foreign currency borrowers, and partly to the more conscious financial thinking of the population. At the end of 2011 and in the first half of 2012, the EUR and CHF exchange rates rose again, causing such a critical situation, mainly due to the high volume of foreign currency-denominated housing loans, that active state intervention was already inevitable.

The Hungarian Financial Supervisory Authority (HFSA) and the National Bank of Hungary (MNB) drew attention to the risks of foreign currency-denominated loans already in 2008, when the population was informed about the risks of Japanese yen-denominated credit schemes. In their joint recommendation, the institutions pointed out that:

- Due to increasing market competition, financial institutions in Hungary face increasingly high financial risks;
- Also due to increasing market competition, financial institutions tend to ease their credit conditions to attract more clients;
- They develop increasingly risky schemes (in order to keep loan interest rates low);
- For a significant part of housing loans, the amount of coverage is already only slightly higher than the amount of the loan; and
- 90% of new residential loans is denominated in a foreign currency.[7]

However, because only one in 25 foreign currency loans was actually denominated in Japanese yen, such a “targeted” warning was not necessarily effective even if its content was generally valid for other foreign currencies as well.

2. The importance of financial consumer protection and financial literacy

Consumer protection is a complex interdisciplinary phenomenon, situated somewhere in the boundary area between modern economics, sociology and law. The aim of consumer protection law is to achieve an equilibrium between two players of the market, i.e. the consumer and the provider.

After the change of regime, the Hungarian economy underwent a fundamental change with the emergence of private ownership, which resulted in a significant and long-term change in the share of the public and private sectors in the production of Hungary’s GDP. Accordingly, the financial environment of business and entrepreneurial activities also changed. Firstly,

[7] https://www.napi.hu/magyar_vallalatok/devizahitel-veszelyekre_figyelmeztet_az_mnb_es_a_felugyelet.360264.html (downloaded on 2/10/2018)

market-economy frameworks based on the roles of the state as a provider-supervisor, as well as a taxer and source-creator were established and became more conscious instead of the former paternalistic approach. Secondly, a financial-advisory-provider sector was also created and is constantly evolving. Thirdly, the consumer goods and services market was also established, and the associated financial services required a kind of knowledge that society was not prepared for.

In the residential sector, the lack of knowledge in the field of financial products and services was primarily reflected in the readiness of the population to take risks in excess of their actual financing capacity and, consequently, in excessive indebtedness. As it became evident during the 2008 economic crisis, these processes also exerted an adverse effect on the development of the financial sector, as they prevented the spread of innovative financial and service schemes and forced providers (banks) into excessive risk competition, resulting in increasing stability risks for the entire financial market.[8]

The concept of financial literacy evidently needs to be defined to get closer to financial consumer protection. Financial literacy as a concept appeared in the United States as early as the turn of the century. It was aimed at increasing residents' financial literacy in order to establish a market for financial products.[9] At that time, the improvement of financial literacy essentially meant the transfer of knowledge about financial products.

However, the period that had elapsed since the turn of the century led to significant innovations in the field of not only consumer items, but also products offered by the financial sector. The 1980s represented the beginning of a large-scale wave of innovation in the segment of financial products. The financial products developed at that time were already so complex that the real risks associated with them were difficult to assess even for professionals dealing with financial matters on a daily basis (e.g. securitisation, unit-linked insurance). Consciously following financial events day by day is far from customary among average consumers, so the financial awareness of a large proportion of society turned out to be far from the level required for the safe use of available financial products.

In emerging economies, there was an increasing need to mitigate the micro- and macroeconomic risks associated with financial behaviour. The need for the dissemination of financial knowledge first emerged in Anglo-Saxon countries.

Defining the concept of financial literacy is of key importance. Studies conducted in the field of financial literacy have always provided a definition for financial literacy depending on their objective, target group or research topic. *Hung et. al.* identified nine important components of financial literacy:[10]

- Financial knowledge;
- Understanding financial processes;
- Ability to apply financial knowledge and experience gained;
- Knowledge of financial relationships and definitions;
- Ability to make informed financial decisions;
- Knowledge of basic financial concepts;

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8 Á. CZAKÓ - I. HUSZ - Z. SZÁNTÓ: *Meddig nyújtózkodjunk? - A magyar háztartások és vállalkozások pénzügyi kultúrájának változása a válság időszakában*, BCE Innovációs Központ Nonprofit Kft., Budapest, 2011.

9 Z. BIEDERMANN: *Az amerikai pénzügyi szabályozás története*, Pénzügyi Szemle, 2012, 337-354.

10 HUNG, A. A. - PARKER, A. M. - YOONG, J. K.: *Defining and Measuring Financial Literacy, Labor and Population,* 2009. 7.

- Ability to make simple (basic) financial decisions;
- Ability to make informed and conscious decisions; and
- Knowledge of basic financial concepts.

In Hungary, the National Bank of Hungary was one of the first institutions to develop a comprehensive definition including several elements of the concept of financial literacy: *"A level of financial knowledge and skills that enables individuals to identify and acquire, and then also understand the basic financial information necessary for them to make informed and prudent decisions, and to make decisions accordingly, assessing the potential future financial and other consequences thereof."* (MNB, 2008).

The State Audit Office also formulated their own definition of financial literacy: *"Financial literacy does not primarily mean the knowledge of banking products and risk-taking behaviour but a level of financial knowledge and skills that enables people to identify and acquire, and then also understand the basic financial information necessary for them to make informed and prudent decisions, and to make decisions accordingly, assessing the potential future financial and other consequences thereof. At the most basic level, financial literacy means that an individual is able to plan and control his or her own finances and budget."*[11]

The development of financial literacy is in the common interest of all economic actors. Leora F. Klapper from the World Bank says the greater the financial literacy of a society, the greater the available savings in the country.[12] Furthermore, research conducted under World Bank coordination emphasises that the financial literacy of the population also contributes to the stability of the financial system.

It is also a fundamental interest of institutions mediating financial services to develop a financial literacy since it contributes to increasing private sector savings and thereby to the improvement of their creditworthiness. Creditworthy clients represent a low-risk source of income for the sector.

The development of a financial literacy is also in the interest of the state, because the existence of a higher-level financial literacy means less effort is required for redistribution and stabilisation, which has a beneficial effect on the competitiveness of the country.

The OECD and G20 countries also recognised that the development of financial education and literacy is a priority nowadays. The OECD issued a recommendation collecting financial education best practices as early as 2005.[13] In 2008, the OECD organised an international cooperation called International Network for Financial Education (INFE), where member states, authorities and non-profit organisations could work together on this important issue. The first results of the research conducted by INFE in 110 countries were summarised in a guideline issued in 2012, entitled Financial Education in Schools.[14] Based on the further development of the research, another guideline was created in 2014, already addressing public institutions and the civil sector, which applies to financial education.[15] This guideline points out that there is no good practice that is applicable to everyone, but a kind of educational cooperation must be established between the parties, which is fruitful for all member states.

In Hungary, the institution participating in the worldwide OECD survey on financial literacy was the State Audit Office.

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11 http://www.asz.hu/tanulmanyok/2014/az-allami-szamvevoszek-szerepe-a-penzugyi-kultura-fejleszteseben/t366.pdf (2/10/2018)

12 KLAPPER, L. - LUSARDI, A. - PANOS, G.: *Financial Literacy and the Financial Crisis, Netspar Discuss Paper,* DP03/2012/007, 2012. 3.

13 OECD Recommendation on Principles and Good Practices for Financial Education and Awareness, 2005

14 OECD/INFE High-Level Principles on National Strategies for Financial Education, August 2012

15 OECD/INFE Guidelines for Private and Not-For-Profit Stakeholders in Financial Education, November 2014

3. Measures aimed at supporting foreign currency borrowers

I previously divided Hungarian state measures aimed at supporting foreign currency borrowers into three groups. While direct actions were aimed at achieving instant or rapid results, actions to improve consumer protection and financial awareness can only be expected to exert an influence in the longer term. In the following section, I will present the measures according to the grouping described above.

Measures / laws aimed at providing direct support	Consumer protection measures / laws	Measures to improve the financial awareness of the population
06 November 2008: Government agreement with 9 major banks **2 March 2009:** Bridging loan with state guarantee **25 October 2010:** Mandatory application of the middle rate, regulation of charges for prepayment and extended maturity term **20 June 2011:** Fixing of exchange rates for repayment, limitation of forced sales **19 September 2011:** Final repayment at fixed rate **14 August 2011:** Social Housing Construction Programme (Ócsa) **05 December 2011:** Establishment of the National Asset Management Company **19 March 2012:** Repeated fixing of exchange rates for repayment **25 November 2014:** Mandatory HUF conversion of mortgage-based foreign currency loans (unless debtor requested unchanged plan with proper justification) **22 September 2015:** HUF conversion of other foreign currency loan contracts	**14 December 2019:** Regulation of the content of loan contracts and the provision of adequate information to consumers **1 January 2010:** HFSA is authorised to act as the financial consumer protection authority **July 2011:** Establishment of the Financial Arbitration Board **04 July 2014:** Regulation of the types of exchange rate used for the HUF conversion of foreign currency disbursements and repayments **07 November 2011:** Determining an upper limit for loan interest rates **01 January 2015:** Introduction of a debt brake (MNB) **1 October 2018:** Tightening the debt brake	**2007**: Economic and financial education was included in the National Core Curriculum **2008**: Establishment of Money Compass Foundation **2014**: Financial Navigator Booklets **2017**: National strategy for the improvement of financial awareness **2018**: Adoption of the first two-year Action Plan for the implementation of the strategy

In Hungary, the responsibility for the crisis situation affecting foreign currency borrowers cannot be clearly and unilaterally assigned to either "party". The responsibility of households lay in the fact that their consumption needs were often not in line with their financial capacities. Also, their financial and market knowledge was insufficient to evaluate the offers of banks, assess the real risk associated with them, and subsequently make an informed decision on borrowing (or non-borrowing). The main responsibility of the banks was that they did not reveal the real conditions of loans in their communication, failed to inform clients about the real risks associated with foreign currency loans, and clearly subordinated their operation to the acquisition of competitive advantage and market expansion, as already evidenced by the sale of foreign currency loans as a product. Furthermore, the responsibility of the state should also be borne in mind regarding whether or not it intervenes as a regulator in the relationship between banks and borrowers, which is basically a classic demand/supply market relationship.[16]

3.1. Government measures aimed at providing direct support to foreign currency borrowers

3.1.1. Agreement signed with banks on 6 November 2008

In order to mitigate the impact of the "first shock" caused by the sudden rise in exchange rates at the end of 2008, the Government signed an agreement with nine commercial banks on **6 November 2008** to ensure that:[17]

- At their request, allow debtors to decrease their instalments free of charge in the event of a significant rise in the monthly amount of instalments by extending the repayment period;
- At the request of the debtor, and based on the decision of the credit institution, credit institutions convert loans denominated in a currency other than HUF free of charge until 31 December 2008, and ensure comparability between the realistically expected total repayment amounts for foreign currency- and HUF-denominated loans to support an informed decision;
- For debtors who got into a difficult situation for reasons beyond their control, particularly in the event of an unexpected loss of job, at the request of the debtor, repayment conditions may be temporarily eased at the discretion of the credit institution;
- Credit institutions flexibly manage prepayments for loans denominated in currencies other than HUF until 31 December 2008.

By the end of 2008, 6,200 people took the opportunity provided through the agreement. 1,200 people requested an extension of the repayment period, 4,100 applied for the prepayment option, and 900 converted their loans into HUF.[18] However, this was only a negligible part of all loan contracts.

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16 CS. LENTNER: A lakossági devizahitelezés kialakulásának és konszolidációjának rendszertani vázlata, Pénzügyi Szemle, Budapest, 3/2015.

17 OTP Bank Zrt., Raiffeisen Bank Zrt., FHB Jelzálogbank Nyrt., Erste Bank Hungary Nyrt., Kereskedelmi és Hitelbank Zrt., MKB Bank Zrt., CIB Bank Zrt., UniCredit Bank Hungary Zrt., Magyar Takarékszövetkezeti Bank Zrt.

18 https://www.portfolio.hu/finanszirozas/bankok/valsagkalauzt-indit-a-kormany.109748.html

3.1.2. Act IV of 2009 on government guarantees for home loans

The National Assembly adopted Act IV of 2009 on government guarantees for home loans on **2 March 2009.** Pursuant to this Act, anyone who lost his/her job after 30 September 2008 was allowed to request a bridging loan by 30 June of the following year to repay a housing loan. Borrowers facing difficulties with repayment could request this option from the bank for two years, and the Hungarian State assumed a joint and surety guarantee for 70% to 80% of the instalments and interests. Another condition for the bridging loan was that HUF 10,000 from the monthly instalment of the housing loan had to be paid by the borrower, and the rest could be covered by the bridging loan. When the two-year term of the bridging loan expired, payments had to be made until the expiry of the residual maturity. The law was amended in June 2009 to allow also those people to take a bridging loan who were not unemployed but were in such a bad financial situation with their families that they were unable to pay the original instalments. According to the explanatory memorandum to the bill, the amendment had to be made because, from the date of the entry into force of the Act, only 300 people took the opportunity to take the bridging loan with state guarantee.[19]

If someone was unable to pay their instalments even in this way, local governments acquired a pre-emption right to purchase the residential units, which they could finally lease to the debtors under more favourable conditions than usual on the market. Based on a survey conducted by the National Bank of Hungary, the number of properties offered for auction was less than 3,000 between September 2008 and May 2009. According to data and estimates provided by banks, approx. 15 per cent of clients with a delay of more than 90 days were actually subjected to foreclosure, which resulted in 5,000 to 6,000 foreclosures per year.[20]

3.1.3. Government Decree 136/2009 on support for persons in crisis (VI. 24.)

By adopting Government Decree 136/2009 on addressing the crisis for the improvement of the socially critical situation of families on **24 June 2009,** the Government established a so-called Crisis Management Fund, with an initial capital of HUF 1 billion, sourced from the extra profit of the four largest Hungarian energy suppliers in the previous year. This allowed families with temporary difficulties due to the global economic crisis to apply for one-time, non-reimbursable aid with a maximum amount of HUF 50,000 or, in cases worthy of special consideration, HUF 100,000. The programme took place between 1 August and 30 November 2009.

3.1.4. Act XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in a difficult situation due to taking housing loans

The National Assembly adopted Act XCVI of 2010 on the amendment of certain finance-related acts in order to support consumers in a difficult situation due to taking housing loans on **25 October 2010.** Among other things, this Act introduced the mandatory application of the middle rate, maximised the amount of prepayment charges, and prohibited creditor banks from charging fees and costs due to the extension of the maturity term (if the maturity was not extended within five years).

[19] https://24.hu/fn/gazdasag/2009/11/09/tobben_kaphatnak_athidalo_kolcsont/ (downloaded on 01/10/2018)

[20] http://www.jogiforum.hu/hirek/21507 (downloaded on 1/10/2018)

3.1.5. Act LXXV of 2011 on fixing the exchange rate used for the calculation of the instalments of foreign currency loans and the forced sale of residential properties

The National Assembly adopted Act LXXV of 2011 on fixing the exchange rate used for the calculation of the instalments of foreign currency loans and the forced sale of residential properties on **20 June 2011**. Its purpose was:

- To address the problem arising from foreign currency lending over the previous period at the level of the entire society;
- To temporarily mitigate the significant exchange rate fluctuations of individual currencies and thereby make the situation of those with a foreign currency loan more predictable; and
- To prevent the simultaneous mass sale of residential properties and the resulting detrimental effects on the real estate market.

The Act required financial institutions to apply a fixed exchange rate for a certain period of time when converting the monthly instalments of foreign currency loans into HUF. This fixed exchange rate was HUF/CHF 180 for Swiss francs, HUF/EUR 250 for euro and HUF 200/JPY 100 for Japanese yen.

A prerequisite for applying the fixed exchange rate was the conclusion of a so-called collective account loan contract. This was a separate account to accumulate the client's debt that he/she had not paid back to the bank due to the difference between the actual and statutory exchange rates. The duration of the payment relief was maximum 36 months from the conclusion of the collective account loan contract, with a maximum expiry date on 31 December 2014. If requested by the financial institution, the Hungarian State was responsible as a joint and surety guarantor for 100% of the debts arising from the collective account loan during the period of the fixed exchange rate. (In addition, the State was responsible as a simple guarantor for maximum 25% of the debts arising from the collective account loan existing at the closing date of the fixed exchange rate after the closing date of the fixed exchange rate.)

The above option was offered by the banks to all eligible clients, but only a small number of clients used this option. This was mainly caused by the high level of HUF interest rates at the time, meaning that the conversion into HUF did not result in lower instalments.[21]

In addition to the possibility of applying the fixed exchange rate, the Act also regulated the forced sale of real estate and required that:

- Until 1 October 2011, it was only allowed to make a sale and publish an auction advertisement on the electronic auction platform operated by the state tax authority if the obligor had previously agreed to the sale personally by means of a written declaration submitted to the state tax authority, or if the mortgage secured a liability arising from a housing loan contract, in which the amount of the loan was higher than HUF 20 million at the time of disbursement, and the commercial value of the residential property in the housing loan contract was higher than HUF 30 million, or

[21] L. KOVÁCS: *A devizahitelek háttere.* Hitelintézeti Szemle, 3/2013. 183-193.

- From 1 October 2011 to 31 December 2014, creditors were only allowed to initiate the forced sale of the collateral property which was designated for this purpose in accordance with the law.

The number of properties designated for forced sale could not exceed the so-called statutory forced sale quotas defined for each county and for Budapest. Accordingly, the ratio of the number of residential properties designated by the creditor for sale in the counties and in the capital between 1 July 2011 and 1 October 2011 could not exceed 2% of the number of total residential properties registered as the collateral of the creditor, 2% again in the fourth quarter of 2011, followed by 3%, 4% and 5% until the end of 2014.

3.1.6. Act CXXI of 2011 on the amendment of certain acts related to home protection

The National Assembly adopted Act CXXI of 2011 on the amendment of certain acts related to home protection on **19 September 2011**. Perhaps the most important provision of the Act was the amendment of Act CXII of 1996 on credit institutions and financial enterprises (hereinafter referred to as "old Hpt"). Pursuant to the amendment, in the event of final repayment under a foreign currency-denominated loan contract using a collateral based on residential property mortgage or a state guarantee, financial institutions had to apply the exchange rates HUF/CHF 180 for Swiss franc, HUF/EUR 250 for euro and HUF 200/JPY 100 for Japanese yen when determining the HUF amount of the final repayment.

Final repayment at a fixed exchange rate was possible (in addition to several other conditions) if a written request was submitted by the borrower accordingly by 30 December 2011. The borrower was also required to agree to the final repayment of the debt arising from the bridging or collective account loan directly related to the foreign currency-denominated loan affected by final repayment. The financial institution was not allowed to charge any reimbursement or other fees in connection with the final repayment.

Considering the fact that the acts aimed to support foreign currency borrowers facing difficulties often resulted in situations where the debtors (or other participants of the transactions) would normally have had to pay duty or tax, the Act included several amendments determining duty or tax exemption for related transactions.

About one-fourth of clients took the opportunity of final repayment at a fixed exchange rate. A quarter of them partly financed their final repayment from a new HUF loan. This option was typically attractive to those who had reserves and/or were creditworthy; this measure was obviously beneficial for them. Looking at the issue from the side of banks, it was precisely the best quality and most creditworthy debtor clientele that disappeared from the portfolio, resulting in a one-off loss and the fall of profitability in the sector.[22]

[22] KOVÁCS: i.m.

3.1.7. Government Decree No. 1279/2011 (VIII. 10.) on the Social Housing Construction Programme

On 14 August 2011, in its decision on the social housing construction programme to support foreign currency borrowers, the Government announced the construction of detached houses with differentiated floor areas depending on family size that:

- Allow home gardening on plots of 1,000 m2;
- Incorporate complete, state-of-the-art and energy-efficient utilities;
- Can be operated with low overhead costs and are equipped with energy efficient technologies, and
- Allow public employment and own work contribution.

The Government appointed Ócsa, a settlement near Budapest, as the location of the project, where they planned the construction of 80 to 100 houses of 40m2, 200 to 220 houses of 50m2, 80 to 100 houses of 60m2, 35 to 55 houses of 70m2 and 20 to 25 houses of 80m2. Finally, only the first 80 houses of the residential community were actually built, which are still used by residents. Initially, the Hungarian Maltese Charity Service also helped families moving into the houses in community buildings.

3.1.8. Act CLXX of 2011 on ensuring housing for natural persons incapable of meeting their payment obligations under their loan contracts

The National Assembly adopted Act CLXX of 2011 on ensuring housing for natural persons incapable of meeting their payment obligations under their loan contracts on **5 December 2011.** The purpose of adopting this Act was to help natural persons who were unable to meet their instalment obligations (despite other measures) and primarily to provide them with housing. A central element of the Act was the establishment of the National Asset Management Company.

The National Asset Management Company purchased and utilised the property serving as the home of the debtor. The most common way of utilisation was letting out the property (typically to the former owner). However, it was also possible to initiate the free transfer of the residential property to local government ownership. The National Asset Management Company bought the property offered by the debtor for sale if:

- The debtor qualified as a socially deprived person;
- The debtor's registered place of residence was the relevant residential property on 28 September 2011 and afterwards continuously;
- The debtor raised at least two children eligible for family allowance in the household;
- The debtor didn't have any other housing options;
- There was a mortgage on the residential property for the benefit of a financial institution, which was established on 30 December 2009 under a mortgage loan contract, and the mortgage loan contract was secured only by the given property;
- The commercial value of the residential property was below HUF 15 million in Budapest and in towns with county status and below HUF 10 million in other settlements;
- When the mortgage loan contract was signed, the amount of the loan was not higher than eighty per cent of the commercial value of the residential property determined at the time of disbursement of the mortgage loan;

- The residential property was designated for forced sale by the financial institution with mortgage rights; and
- All financial institutions with mortgage rights on the residential property have agreed to transfer ownership of the residential property to the State and have accepted part of the purchase price be paid by the National Asset Management Company in exchange for waiving any other claims on the debtor.

The purchase price of the residential property was 55% of the commercial value of the associated mortgage loan contract if the residential property was located in Budapest or in a town with county status, 50% if in another city, or 35% if in a village. When signing the sales contract, the National Asset Management Company granted the right of repurchasing the property. If, simultaneously with the conclusion of the sales contract, the National Asset Management Company signed a housing rental contract with the debtor, the lessee was obliged to pay the agreed rent to the National Asset Management Company on a monthly basis.

3.1.9. Act XVI of 2012 on the amendment of Act LXXV of 2011 on fixing the exchange rate used for the calculation of the instalments of foreign currency loans and the forced sale of residential properties

The National Assembly adopted Act XVI of 2012 on the amendment of Act LXXV of 2011 on fixing the exchange rate used for the calculation of the instalments of foreign currency loans and the forced sale of residential properties on **19 March 2012**. From 1 April 2012, the amendment reopened the possibility of fixing the exchange rate for consumers with foreign currency loans and foreign currency-denominated real estate leasing schemes.

The fixed exchange rate was HUF/CHF 180 for Swiss franc, HUF/EUR 250 for euro and HUF/JPY 2.5 for Japanese yen. Similarly to the previous scheme, credit institutions registered the difference between the instalments calculated with the actual and fixed rates in a so-called collective account during the period of exchange rate fixing, split into two parts (capital and interest). However, the exchange rate difference for the two parts had to be paid for the capital component only, because the Hungarian State undertook to pay the exchange rate difference for the interest. The law also introduced the concept of “highest exchange rate”, which was intended to ensure that excessively high exchange rates should not impose an additional burden on families with foreign currency loans or on the state. The highest exchange rate was HUF/CHF 270 for Swiss franc, HUF/EUR 340 for euro and HUF/JPY 3.3 for Japanese yen.

As an important prerequisite for the use of exchange rate peg, the HUF amount of the foreign currency loan calculated with the exchange rate applied at the time of disbursement could not exceed HUF 20 million, unless the debtor lived in a common household with at least three children in the residential property serving as collateral for the foreign currency loan.[23]

This programme was a real help for about 40% of eligible clients.[24]

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23 https://www.mnb.hu/archivum/Felugyelet/root/fooldal/fogyasztoknak/fizetesi_nehezsegek/arfolyamrogzites#Miként működik az új árfolyamrögzítés és hogyan vehető igénybe? (downloaded on 23/9/2018)

24 KOVÁCS: i.m.

3.1.10. HUF conversion of mortgage loans

The National Assembly adopted Act LXXVII of 2014 on settling certain issues related to the conversion of the currency of certain consumer loan contracts and to the rules governing interest rates on **25 November 2014**. This required financial institutions to convert into HUF all foreign currency debts or debts existing on the basis of consumer mortgage loan contracts denominated in a foreign currency (interest, fees, commissions, other costs). The average exchange rate of the given currency as officially quoted by the National Bank of Hungary between 16 June 2014 and 7 November 2014 or the exchange rate quoted on 7 November 2014 (whichever was more favourable for the consumer) had to be used as a conversion rate. The interest rate on converted HUF loans had to be linked to the three-month BUBOR and the original interest surcharge had to be applied, which could not be less than 1%, but could not exceed 4.5% for a consumer mortgage loan contract for housing purposes and 6.5% for a consumer mortgage loan contract for non-housing purposes.

The law made it possible to leave the loan contract unchanged if explicitly requested by the debtor, and if the debtor could demonstrate that:

- He/she had a regular income in excess of the expected instalment in the given currency, or
- The remaining term of contract would expire on 31 December 2020 at the latest, or
- The interest calculated for HUF conversion based on the Act exceeded the interest or interest surcharge initially calculated.

3.1.11. HUF conversion of motor vehicle and personal loans

The National Assembly adopted Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables arising from certain loan contracts on **22 September 2015**. The scope of the Act covered those still effective foreign currency-denominated loan contracts that had not been previously involved in HUF conversion and that had not been provided on the basis of mortgage registered on the property. Pursuant to the Act, financial institutions were obliged to convert foreign currency receivables into HUF (both from existing and already terminated contracts) using the exchange rate officially quoted by the National Bank of Hungary on 19 August 2015.

3.2. Financial consumer protection measures

3.2.1. Regulation of the content of loan contracts and the provision of adequate information to consumers

The National Assembly adopted Act[25] CLXII of 2009 on consumer credit on **14 December 2009**. This included, among other things, rules for the following fields to protect the interests of borrowers:

- Commercial communication on loans;
- Information to be provided before a loan contract is signed;
- Form and content requirements for loan contracts;
- Obligation to provide information on changes in the costs of loans;
- Prepayment.

25 Act CLXII of 2009 transposed Directive 2008/48/EC into Hungarian law

As part of the rules on commercial communication, the Act required credit institutions to indicate the value of the Annual Percentage Rate (APR) prominently with the Hungarian abbreviation, with an accuracy of one decimal place. If, in addition to the value of the Annual Percentage Rate, communication contained a loan interest rate or numerical data regarding any other consideration (fee, commission, cost), then these had to be presented clearly, concisely and prominently, with a representative example.

It was also stipulated that, prior to concluding the contract, the creditor had to inform the consumer, on paper or other durable medium, about several parameters of the loan as required by law. A copy of the loan contract, the content of which was regulated in detail by the Act, had to be provided to the borrower and, during its term, the creditor had to inform the consumer free of charge about his/her debt at the request of the borrower or, for mortgage loans, once a year. The repayment table had to indicate separately the amount of instalments, the frequency and conditions of repayment, and any other consideration items for each instalment. If the interest or any other consideration was changed, the consumer had to be informed in writing before the entry into force of the amendment. Such information had to cover the expected amount of instalments becoming due after the modification and, if that leads to a change in the number or frequency of instalments, such change too.

The Act stipulated that the consumer always had the option of (partial or final) prepayment. However, the creditor was entitled to ask the borrower for reimbursement of its related reasonable costs. This means prepayment did not have to be free of charge, but, as a rule of thumb, its charge could not exceed one, or half a per cent of the prepaid amount. In the case of a mortgage loan, the maximum prepayment charge was two per cent of the prepaid amount, while in the case of loan contracts financed on the basis of a mortgage deed it was two and a half per cent of the prepaid amount.

As far as misleading financial advertisements are concerned, the Hungarian Competition Authority acts as a consumer protection authority against financial service providers. A clear requirement for advertisements and commercial practices intended for consumers is that the consumer should be able to form a realistic picture of the given product.

3.2.2.Granting consumer protection power to the Hungarian Financial Supervisory Authority

In 2008, the Parliamentary Commissioner for Civil Rights conducted an investigation to find out to what extent the enforcement of consumer rights of citizens using financial services could be guaranteed by the relevant regulations and by the competent public bodies.[26] The Parliamentary Commissioner considered it important that as many of the relevant state bodies as possible, including the Minister of Finance, the Minister of Justice and Law Enforcement, the then Director General of the Hungarian Financial Supervisory Authority (HFSA), the Director General of the National Consumer Protection Authority, and the commissioner responsible for the "New Order and Freedom" program be involved in this extremely important issue.

[26] OBH 1600/2008. (downloaded on 30/09/2018)

Therefore, prior to publishing his report, he contacted these public institutions in connection with several questions, among other things the violation of the rules on residential loan contracts, the unilateral amendment of contracts, the information practices of financial institutions, the transparency of contractual conditions, the practices for collecting receivables, the institution of residential bankruptcy, the procedures of conciliation bodies, responsible lending, and the consumer protection activities of the HFSA and the National Consumer Protection Authority.

The Parliamentary Commissioner for Civil Rights examined the enforcement of consumer rights related to financial services, the relevant practices of the competent state institutions, and the enforcement of the right to a fair trial.

In his report, the Parliamentary Commissioner pointed out some serious problems with the practice applied by the HFSA. In particular, the HFSA examined the problems appearing in the complaints submitted by financial consumers only in its standard audits, mostly incorporated in its usual comprehensive investigations, rather than within the framework of separate investigations. Consumer protection deficiencies were also sanctioned by means of decisions closing prudential investigations. According to the Commissioner, it was incompatible with the requirements of the rule of law that the supervisory authority did not act separately in individual cases. The Ombudsman emphasised that the requirement of acting separately in individual cases did not mean that the HFSA should or may take over jurisdiction for the settlement of disputes between the parties. The Ombudsman's position was that the HFSA could apply the provisions of the Consumer Protection Act. In his report, the Parliamentary Commissioner also drew attention to the fact that it was anomalous from the perspective of legal certainty that the state (the regulation) imposed hardly any limitations on the activities of financial service providers in a dominant position with respect to consumer protection. At the same time, it provided consumer protection tools to clients in a much weaker position to a limited extent only.

This dispute became devoid of purpose after the entry into force of Act XLVII of 2008 on the prohibition of commercial practices unfair vis-à-vis consumers. The new Act granted the HFSA the power of consumer protection authority from **1 January 2010** and resulted in a number of organisational changes.

3.2.3. Establishment of the Financial Arbitration Board

The Financial Arbitration Board (hereinafter referred to as FAB) started its activity in **July 2011** within the organisation of the HSFA, currently operating in conjunction with the National Bank of Hungary. The FAB is an alternative, free-of-charge dispute resolution forum with the task of effectively supporting the rapid, cost-effective and efficient resolution of consumer complaints regarding contractual relationships with financial service providers such as credit institutions, insurance companies and investment enterprises. The FAB is not an authority but a forum for consumers for the settlement of disputes as an alternative for/ prevention of lengthy, time-consuming and costly court proceedings.

The procedure requires the consumer to manage his/her case in the same way as in court: in addition to presenting their position, he/she should also support it by evidence, appear at the hearing, or be represented by a proxy.

The legislative objective of setting up the FAB was to evaluate consumer disputes quickly, efficiently and effectively, but in order to strengthen consumer awareness, the Act conditions the use of the FAB on the existence of conjunctive conditions:

- The consumer should make an attempt to settle the dispute directly with the financial service provider;
- No other proceeding should be pending regarding the same legal dispute.

3.2.4.Regulation of loan interest rates

Act CXII of 1996 on credit institutions and financial enterprises (hereinafter referred to as, old Hpt) imposed certain limitations on the APR already before the regulation, which entered into force on 1 April 2012. The scope of the regulation, of course, covered financial organisations to which the old Hpt. applied. Accordingly, in one calendar year, a financial institution was only allowed to grant a loan with an APR above 65% to the same client once a year, and the amount of the loan could not exceed HUF 250,000. In addition to the old Hpt, Act IV of 1959 on the Civil Code. (hereinafter referred to as, the old Civil Code) also contained provisions on consumer loans. Furthermore, the provisions of the Criminal Code punish usury activities.

The National Assembly adopted Act CXLVIII of 2011 on the amendment of financial regulations in connection with the restriction of credit interest rates and the annual percentage rate and for ensuring transparent pricing mechanisms on 7 November 2011. As an amendment of the old Civil Code, this Act stipulated that, unless otherwise determined by the parties or an exception is specified by law, the interest rate should be identical with the base rate of the central bank, or, between private individuals, it can be maximum 24 percentage points higher than the base rate of the central bank. The Act also amended the old Hpt., stipulating that the upper limit of the annual percentage rate of the loan granted by the financial institution was the base rate of the central bank + 24 percentage points. An exception to this rule was the annual percentage rate applicable to loans related to credit card contracts or payment accounts, loans granted for the purchase of equipment for everyday use or consumer durables (not including motor vehicles), loans for the use of services, or loans granted under pledge; here, the upper limit was the base rate of the central bank + 39 percentage points. The changes applied to contracts signed after 1 April 2012.

Furthermore, in the case of mortgage loan contracts signed after 1 April 2012, the financial institution was no longer allowed to charge, in addition to the interest rates specified in the contract, any other interest-like fees or costs payable on a regular basis (if the client repaid the loan on time and in accordance with the contract). After the amendment, it was no longer possible for the financial institution to offer a preferential interest rate when concluding the contract. This frequently led to a situation where borrowers were unable to properly assess their own repayment capacity, and, after the expiry of the preferential period, could no longer pay the instalments calculated with higher interest rates.

Possibilities for changing the interest rate were also regulated. Two methods were defined for this purpose:

- Pricing based on a reference interest rate: when the interest rate payable by the client consists of a reference interest rate and the specified interest surcharge, or
- Fixed interest rate: when the interest rate is fixed for 3, 5 or 10-year interest periods as specified in the loan contract, i.e. the interest rate remains unchanged in this period.

In the case of a fixed interest rate, the client is entitled to terminate the contract and make a prepayment free of charge if the new interest rate is not acceptable to him/her, but in that case the total amount of outstanding debt must be repaid.

According to the regulation, a financial institution is allowed to increase the interest surcharge only if the client is in default of the payment of a monthly instalment for more than 45 days or fails to pay the property insurance for the collateral real estate for at least two months.

3.2.5. Regulation of the exchange rate used for the HUF conversion of disbursement and repayment

The National Assembly adopted Act XXXVIII of 2014 on the resolution of questions relating to the uniformity decision of the Curia regarding consumer loan contracts of financial institutions on **4 July 2014.** According to this Act, it was no longer allowed for financial institutions to apply the buying rate of exchange for the HUF conversion of the disbursement and, in deviation from that, the selling rate or any other rate for the repayment of the debt. Instead, the official exchange rate of the National Bank of Hungary had to be used for both the disbursement and the repayment (including instalments, as well as any costs, fees or commissions denominated in a foreign currency).

3.2.6. Introduction of a debt brake

The debt brake regulation, which entered into force on **1 January 2015,** consisted of two main pillars:

- The *income-based instalment index* limited the maximum repayment burden that could be imposed on a client to a definite percentage of their regular, legal income, while
- For covered loans, the loan coverage ratio limited the amount of loan that could be granted to a proportion of the collateral (e.g. value of property).

Pursuant to the regulation of the National Bank of Hungary, the income-based instalment index had to be examined for all new loans in excess of HUF 200,000 (consumer loan, mortgage loan, motor vehicle loan, etc.). In the case of new HUF loans taken after 1 January 2015, the income-based instalment index could not exceed 50% or, for clients with a net income above HUF 400,000, above 60%. These limits were stricter for loans denominated in euro or other foreign currencies: 25% for euro, 10% for other currencies, and 30% (euro) and 15% (other currencies) for high-income clients.

For mortgage loans, the loan-to-value ratio, i.e. the ratio between the amount disbursed and the market value of the collateral, could not exceed 80% (HUF loans), 50% (EUR loans), or 35% (other foreign currency loans). These ratios were somewhat stricter for motor vehicle loans (75%, 45%, and 30%).

From 1 October 2018, the National Bank of Hungary modified the value of the income-based instalment index in order to give a further incentive for the use of mortgage loans with a fixed interest rate. In the case of HUF-based mortgage loans accepted after 1 October 2018 with a maturity period of over five years, credit institutions must apply the following limits:[27]

	Interest period		
Monthly net income	**Varying interest – 5 years**	**5 years – 10 years**	**10 years – until the end of the term**
Below HUF 400,000 (HUF 500,000 from 1 July 2019)	25%	35%	50%
HUF 400,000 (HUF 500,000 from 1 July 2019) or above	30%	40%	60%

3.3. National strategy for the improvement of the financial awareness of the Hungarian population – National strategy and action plan for the improvement of financial awareness

School-based financial education in Hungary was launched under the initiative of the National Bank of Hungary, the discontinued Hungarian Financial Supervisory Authority, the Ministry of Finance, the Economic Competition Authority and several NGOs. Economic and financial education was also included in the National Core Curriculum in 2007. The goal of expanding the National Core Curriculum was to enable students to make their future economic decisions responsibly, aware of potential advantages and disadvantages. Already in 2007, initiative and entrepreneurial competence were included in the National Core Curriculum as key competencies, and economic and financial education appeared as major development areas.[28] During the review of the National Core Curriculum in 2012, the discussion paper was also debated publicly, which resulted in a package of recommendations for secondary school teachers with the following key points:

- Introduction and teaching of the subject economic and financial skills;
- Harmonisation of economic and financial skills, launch of accredited further training programmes, development of educational and methodological materials (theory and practice).

[27] https://www.mnb.hu/sajtoszoba/sajtokozlemenyek/2018-evi-sajtokozlemenyek/megjelent-az-adossagfek-szabalyok-modositasarol-szolo-mnb-rendelet (downloaded on 02/10/2018)

[28] http://epa.oszk.hu/.../EPA00035_upsz_2011_07_117-139.p (downloaded on 02/10/2018)

The National Bank of Hungary has long been making efforts, both on their own and in cooperation with several institutions, to spread financial literacy. The National Bank of Hungary launched a programme called *"For our Everyday Finances"*, under the coordination of the Money Compass Foundation, established in 2008, involving a number of banks and insurance companies.[29]

The Financial Consumer Protection Centre, established by the National Bank of Hungary, has been coordinating the publication of the Financial Navigator Booklets since November 2014. The purpose of these free information booklets is the further improvement of financial awareness at national level.

The Ministry for National Economy (currently Ministry of Finance) is particularly interested in strengthening the financial awareness of the population in order to carry out its tasks regarding the stability of the regulatory system for economic and financial policy. Accordingly, the Government appointed the Ministry of National Economy as a Government Centre for the improvement of financial awareness in 2016.

On 8 December 2017, the Government adopted Government Resolution 1919/2017 (XII. 8.) on the adoption of a strategy for the improvement of the financial awareness of the population. The adopted Hungarian strategy was developed taking into consideration the OECD/INFE guidelines and the best international practices, also bearing in mind special Hungarian needs. Its evolutive nature allows it to easily adapt to the expectations arising from the rapidly changing environment and any new challenges appearing, e.g. digital financial services. The draft strategy was also reviewed by the OECD/INFE. It gave very positive feedback, emphasising that the Hungarian Government had been able to compile a high-quality material in a very short time.

An important mission of the new national strategy is to set a unified national strategic direction for several current initiatives, which have been in progress for many years but support fragmented financial literacy (e.g. National Bank of Hungary, State Audit Office, Hungarian Banking Association, Association of Hungarian Insurers), to clarify priorities, and to concentrate resources expediently. The strategy also gives room for the maximum exploitation of synergies between state initiatives and programmes implemented by the non-governmental and business sectors.

Under the coordination of the Ministry of Finance, with nation-wide professional cooperation (National Bank of Hungary, Ministry of Human Resources, State Audit Office, Central Statistical Office, Hungarian State Treasury, interest group associations and NGOs), the objective of the Government was achieved within one year, and a national strategy for improving financial awareness was developed.

The strategy developed covers a period of 7 years, which will be broken down into two-year rolling action plans built on one another, indicating task, institution and infrastructure. Its primary target group is made up of children still at school, but it uses a wide range of programmes to reach adults as well, and even retired persons are addressed. The action plans of the strategy are aimed at helping vulnerable social groups, too.

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[29] http://www.penziranytu.hu/mindennapi-penzugyeink-elindult-tanartovabbkepzes (downloaded on 10/10/2018)

The strategy defined its objectives, set its directions and identified the necessary steps in the knowledge of the deficiencies revealed through the surveys. Its efficiency will be measured, self-correction and new challenges emerging in the meantime will be incorporated into the implementation of the strategy in the light of results and weaknesses. The indicators for measuring the efficiency of the strategy were developed relying on the expertise and with the active participation of the Hungarian Central Statistical Office. These indicators will reveal the effectiveness and success of the measures defined in the action plans at the end of each year. The seven main objectives of the first two-year action plan of the national strategy are the following:

1. Creating, strengthening and generally introducing the possibilities of real financial education in the **public education** system, introducing compulsory education with meaningful financial content, both in primary and secondary education. The National Core Curriculum, currently under preparation, offers an excellent opportunity for renewing the education of financial skills, directly reaching schoolchildren, the most responsive and important target group, and providing strong policy support for a national strategy for improving financial awareness. It is necessary to create the foundations for the financial education of teachers, child protection professionals and social workers.
2. Developing **conscious financial behaviour** and strengthening the financial stress tolerance of households by improving their knowledge, confidence and attitudes towards financial matters. It is important that the practice of creating family budgets becomes widespread.
3. Establishing an approach that promotes **prudent financial decisions** and creating and making people generally familiar with institutions/infrastructures that support conscious financial consumer behaviour. As a key objective, the consumer should receive guidance for the right choice and should be able to compare competing financial products in the simplest and most transparent way to make an optimal decision.
4. It is necessary to strengthen the **self-care** approach of the population. In particular, the inclination for savings, insurance and investment related to financial goals and typical life situations should be increased.
5. Significantly increasing access to financial products and basic financial services and **financial inclusion,** and ensure the availability of basic financial services for those who are still outside the financial system (creating the conditions for basic social accounts).
6. **Encouraging the use of state-of-the-art non-cash payment instruments,** promoting digital solutions, which will lead to significant savings at the level of national economy and further whiten the economy.
7. Promoting **prudent borrowing**. As a basic objective, the attitudes of the population should be changed; they should not seek quick financial solutions, but those that are carefully selected. This process will also be fostered by regulatory support for the development of simplified, transparent and comparable credit products.

During the implementation of the action plan, the methods for reaching each target group will be chosen in a way that they function as effective communication channels:

- Students in the school system would be reached through a special curriculum, and financial education should remain part of the compulsory curriculum. In addition, the organisation of theme weeks and summer camps can be expected, and school newspapers, school radio networks with nation-wide distribution will also be used.
- When trying to reach students in higher education, the autonomy of higher education institutions must be taken into account, i.e. they should be given the opportunity to provide practical financial education at their own discretion through optional subjects.
- The most efficient method of addressing young graduates is to organise programmes for last-year students in secondary and tertiary educational institutions. These will be constituted by events and trainings organised by employers, NGOs and professional associations.
- The active members of the adult population can be reached through trainings organised by employers, NGOs, professional associations, financial advisors, media campaigns, or information materials published on the website. They must be made familiar with the risks associated with borrowing and investment, and their attention must be drawn to the various types of insurance and the preferential schemes that are linked to situations arising from their age.
- The action plan treats people saving money for pension purposes as a separate group. It is a general societal and economic interest that the population understand the importance of self-care, so the focus is on encouraging self-care in this target group. This objective can be achieved by making use of the media's awareness-raising role and the expert content published on the website.
- Pensioners can be reached through a network of clubs for retired people, the social security system, NGOs, and the Financial Advisory Office Network.
- Communication with "vulnerable groups" (groups of society after job loss or family tragedies, families with low income, people with disabilities) will be greatly helped by NGOs, social workers and the media, and, in order to lay the foundations for financial awareness, links must also be created to public employment programmes, which have a key role in helping public workers to enter the labour market.

A key role in evaluating the results of the strategy and completing the tasks is played by the National Financial Literacy Working Group, an operational inter-ministerial body (chaired by Secretary of State of the Ministry of Finance in charge of Finance). Members of the Working Group are delegated by the Ministry of Finance, the Ministry of Human Resources, the National Bank of Hungary, the Money Compass Foundation of the National Bank of Hungary, the State Audit Office, the Central Statistical Office and the Hungarian State Treasury.

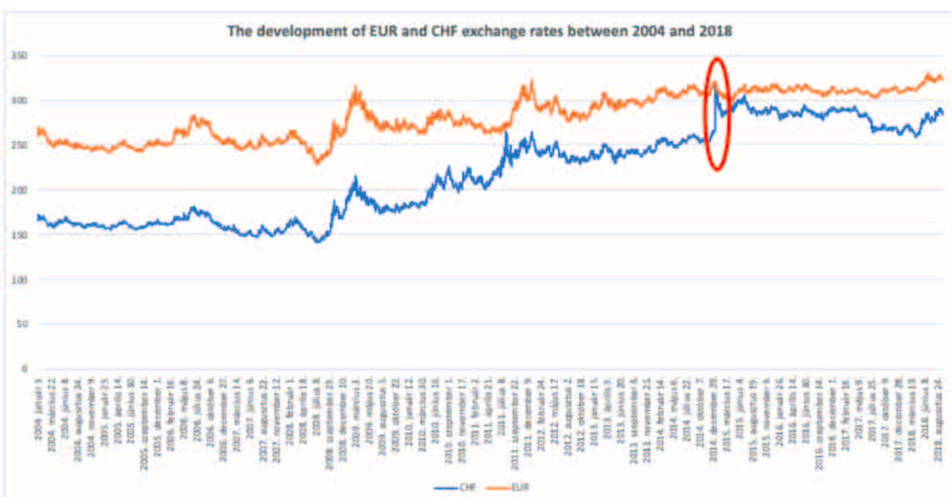
4. Summary

The role of the Hungarian State fundamentally changed after 2008 as a result of measures taken to address the problem of foreign currency loans. Instead of the previous neoliberal approach, which built on the ability of market economy to keep market players under control by means of self-regulation, it clearly took up a regulatory position. The analysts of Barclays Capital considered the measures providing support to foreign currency borrowers as a decent compromise with no substantial market impact and, in their opinion, the Hungarian Government took a middle course by opting for a solution to transfer some of the risks arising from foreign currency loans from households to the Government and banks, which does not eliminate but only shifts, in time, the burden of serious indebtedness.

Foreign currency loans were finally converted into HUF in spring 2015; the exchange rate was HUF 309 for euro and HUF 256.6 for Swiss franc. These rates were higher than those between 2002 and 2008, when the loans were taken out, but, due to the distribution of responsibilities, the burden could not be entirely transferred to banks.

The primary objective of the measures taken by the Hungarian State after 2008 was to prevent a stressful situation in a field of key importance for the residential sector (housing), whose potential spill-over effects would have been unpredictable. Not to mention the possible consequences of the situation when, on 15 January 2015, the Swiss central bank gave up the protection of the Swiss franc against the fluctuation of the euro exchange rate, and the HUF/Swiss franc middle rate jumped from around 240 to 260 to over 300.[30]

Figure 4: The development of EUR and CHF exchange rates



[30] Edited internally using statistical data from the website of the National Bank of Hungary.

The measures aimed at rescuing foreign currency borrowers in themselves would probably not have been able to achieve significant results, but by offering different solutions to different client segments, for many consumers they led to a more predictable burden or a chance to keep their homes.[31]

Although there is still a lot to do in the field of financial literacy, the situation is hopeful. The improvement of financial literacy is a common economic interest, which requires joint action by the financial sector, economic operators and the state. The lack of financial literacy in society is so prominent that it currently prevents rapid recovery from cyclical economic crises. Practice-oriented training should cover all levels of society, which will have a beneficial effect on people's ability to make good financial decisions and will thus exert long-term macroeconomic effects.

[31] KOVÁCS: i.m.

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ON THE LEGAL ISSUES AND LESSONS LEARNED FROM LITIGATION RELATED TO CONSUMER CURRENCY-BASED LENDING

This study aims to present the characteristic legal problems and issues of law arising in the so-called 'legal proceedings involving foreign currency loans' initiated or ongoing in very large numbers. In this context, the answers elaborated by judicial practice will be also examined. The areas where there is no established legal practice will be also indicated. However, we stress that are still a large number of legal proceedings in progress on this subject matter and there are many preliminary ruling proceedings before the Court of Justice of the European Union (hereinafter referred to as "CJEU"). Therefore, the present study can by no means be considered a final summary.

In this study, 'foreign currency-denominated loan contracts' include both foreign currency-denominated credit agreements and foreign currency-denominated financial leasing contracts. However, these contract types are analysed separately in certain cases.

Due to space limits, neither the procedural problems that have arisen in the context of foreign currency-denominated lending, nor the issues of law emerging during the execution proceedings are addressed, The issues arisen in the non-litigious proceedings conducted with regard to the settlement are not discussed, either.[1]

The present study does not aim to explore and present in a complex way the reasons why foreign currency-denominated consumer lending came into prominence and became almost exclusive in the period between 2004 and 2008. The present study does not aim, either, to examine the severe economic, social and societal problems caused by the spread of this legal instrument.

1. Challenges for the court system in consequence of the legal proceedings related to foreign currency-denominated lending

We believe that, in the past 40 years, the Hungarian justice system did not encounter a situation similar to the one caused, and still being caused, by the legal proceedings initiated in relation to foreign currency-denominated lending.

One of the main characteristics of this situation is that the litigations related to the foreign currency-denominated loan contracts commenced many years after the conclusion of the contracts. These litigations aimed at establishing that the contracts have either not been concluded or are not valid. Therefore, the statements of claim were filed when the exchange rate of the Hungarian Forint had significantly and permanently weakened compared to the imposing foreign currency, i.e. the Swiss Franc (CHF) and, to a lesser degree, the Euro (EUR). This created such a situation for the borrowers that they could not or did not want to carry the increased burdens. The burden of the borrowers was further increased by the fact that more and more financial institutions started to make use of the opportunity of unilateral increasing the interests, charges and fees allowed by Act CXII of 1996 on Credit

[1] The settlement between the financial organisations and the consumers has taken place pursuant to Act XL of 2014 on the Rules of the Settlement and Certain Other Issues Set out in Act XXXVIII of 2014 on the Resolution of Questions Relating to the Uniformity Decision of the Curia Regarding Consumer Loan Agreements of Financial Institutions.

Institutions and Financial Enterprises (hereinafter referred to as “Old CIA”). In addition, almost all financial institutions have used a so-called two-level exchange rate (i.e. different purchasing and selling exchange rate) n the foreign currency contract scheme and also continuously increased the margin between the two exchange rates.

On the one hand, the very large number of cases and, on the other hand, the almost simultaneous commencement of proceedings threw a challenge to the courts.[2] A further challenge is that substantially identical contractual provisions (unilateral contract amendment, application of purchasing and selling exchange rates, certification of facts, etc.) were included in the foreign currency-denominated loan contracts in many cases due to their similar design.

It is obvious that, in a situation with an unprecedented number of legal proceedings being or having been in progress, enforcing the requirement of legal uniformity has utmost importance. This is also underlined by the fact that even though the legal proceedings commenced before the different types of courts (i.e. partly at the district courts and partly at the regional courts) largely similar points of law arisen were raised. It was the fundamental expectation of both the litigious parties and the society that the courts acting in the cases should uniformly interpret the relevant legal norms and the contractual provisions, if possible. In accordance with its constitutional obligation to create legal uniformity, we believe the Curia has played and still plays a major role in answering the points of law in a uniform manner.

In order to ensure legal uniformity at the highest possible level, the Curia has issued several guidelines of principle. In relation to foreign currency-denominated lending, the Curia has passed four civil judicial uniformity decisions (PJE decisions)[3] and three division opinions (PK opinions).[4] Two legal practice analysing groups have been set up on this subject matter.

In order to further develop the legal practice, two[5] out of the four judicial uniformity decisions were passed by the Civil Division of the Curia, thus giving a greater weight to the content within. The judicial uniformity decisions are of a high importance because their content is binding on the courts.[6] The importance of PJE Decision 2/2014 is also increased

2 600 actions related to foreign currency lending were filed in November and December 2013. Nearly 36,000 cases concerning foreign currency loans were submitted to the courts between 1 November 2013 and 31 December 2016. (Source: NJO)

3 Civil decisions of principle: 5/2013. PJE decision, 6/2013. PJE decision, 2/2014. PJE decision, 1/2016. PJE decision

4 Division opinions: PK Opinion 2/2011 (XII.12.) on certain issues concerning the validity of consumer contracts (hereinafter referred to as "PK Opinion 2/2011"), PK Opinion 3/2011 (XII. 12.) on certain issues concerning the consideration of actions in the public interest with regard to consumer contracts (hereinafter referred to as "PK Opinion 3/2011"), PK Opinion 2/2012 (XII.10.) on the unfairness of the right to uniform contract amendment included in the general terms and conditions used by financial institutions in consumer loan agreements (hereinafter referred to as “PK opinion 2/2012”).

5 PJE Decision 6/2013, PJE Decision 2/2014

6 Act CLXI of 2011 on the Organisation and Administration of Courts of Hungary, point c) of Section 24 (1).

by the fact that the provisions of certain acts are partly based upon this decision, which is sufficiently reflected by the name of the acts.[7]

The Curia has passed three division opinions on the subject matter being discussed. Two of the opinions are dealing generally with the points of law arisen in relation to consumer contracts, while the third PK opinion issued guidance on questions related to unilateral contract amendments. It must be noted that these division opinions were passed when legal disputes concerning consumer contracts or foreign currency-denominated lending had only sporadically been submitted to the supreme judicial body.[8]

Two legal practice analysing groups have been working on this subject matter. The result of the work of the legal practice analysing group earlier set up was the PL Opinion 2/2012.[9] The summary opinion drafted by the other legal practice analysing group set up in 2015, dealing with the application of the legal consequences of the invalidity of loan contracts (hereinafter referred to as "legal practice analysing group on the legal consequences of invalidity") was adopted by the Civil Division of the Curia and can be read on the website of the Curia.[10] However, given that none of the positions had a convincing majority on the points of law arisen and long disputed, no guidelines of principle were issues in addition to the summary opinion.

Naturally, the Curia does not direct legal practice only by means of judicial uniformity decisions and division opinions but also through individual decision taken in specific cases. A number of landmark decisions have been published in the periodical called 'Judicial Decisions' (BH). Out of the case law decision, one has been published as decision of principle[11] and two others as resolutions of principle.[12] The large number of cases brought before the Curia made it necessary that not only one but more chambers judge in cases of subject-matter. The chambers handling the cases involving greater importance or recurring points of law strive to informally agree on their legal position. The role of Curia to unify the law has not been and is not limited to the instruments specified in the Act above, but has played and still plays a significant role in developing the positions of other bodies.

When the number of legal proceedings concerning foreign currency-denominated lending has suddenly increased the legal interpretation was extremely ambiguous on many issues.

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7 Act XXXVIII of 2014 on the Resolution of Questions Relating to the Uniformity Decision of the Curia Regarding Consumer Loan Agreements of Financial Institutions (hereinafter referred to as "DH1 Act"), as well as Act XL of 2014 on the Rules of the Settlement and Certain Other Issues Set out in Act XXXVIII of 2014 on the Resolution of Questions Relating to the Uniformity Decision of the Curia Regarding Consumer Loan Agreements of Financial Institutions (hereinafter referred to as "DH2 Act")

8 This is supported by the fact that the courts could only submit 27 final judgements to the legal practice analysing group set up before the issuance of PK Opinion 2/2012 PK that covered the above points of law.

9 The summary opinion of the legal practice analysing group is available on the website of the Curia: https://kuria-birosag.hu/sites/default/files/joggyak/joggyakorlat_osszefoglalo_velemeny.pdf

10 https://kuria-birosag.hu/sites/default/files/joggyak/osszefoglalo_velemeny_i.pdf

11 Civil decision of principle P.2. of 2016

12 Economic decision of principle G.1. of 2015; economic decision of principle G.1. of 2018

Therefore, the Conference of Heads of Civil Divisions has taken and published several positions concerning this topic.[13] We refer to many of these positions in this study.

In addition, the President of the Curia has established a consultation body dealing with the invalidity of contracts falling within the scope of acts concerning foreign currency loans. It has as its members judges who preside over such cases at different judicial levels. In addition, the senior advisers of the Curia dealing with such cases also support the work of the consultation body. The legal position of the consultation body has been published several times;[14] we also refer to some of these positions. In other cases, the positions have not been published but the discussions have contributed to identifying the problems arisen, recognizing the potentially different legal positions and bringing closer the positions.

Another characteristic of the issues of law raised by the foreign currency-denominated loan contracts is the well-observable direct interaction of law-making and application of the law. The DH1 and DH2 Acts were partly based on the PJE Decision 2/2014. The DH2 Act has also made a decision on a point of law, which the legal practice analysing group on the legal consequences of invalidity was unable to decide due to the division of opinions.

The typical legal arguments appearing in the legal proceedings have periodically changed. Initially, reference was made to the invalidity of the contractual design, the obvious contradiction to good morals, the usury nature, the impossibility of the service in and fraudulent nature of the contracts. Later, it became characteristics to request that the entire contract is declared null and void due to the violation of provisions laid down in Section 213 (1) of the Old CIA (typically without applying the legal consequences). This was made possible by Section 239/A of Act IV of 1959 on the Civil Code (hereinafter "Old Civil Code").

At the same time, the question of unfairness of certain contractual provisions emerged in a significant number of legal proceedings. In this context, reference was made to the unfairness of the contractual provisions allowing the unilateral modification of interest, charges and fees, as well as the use of the two-level exchange rate (purchasing and selling exchange rates). They also claimed that insufficient information had been provided on that the exchange rate risk is borne by the borrowers.[15] There is a large number of cases in progress related to the judgement of the unfairness of certain provisions of the notarial certifications of facts in the contracts and the mortgage agreements concluded for securing the loan agreements.

It is typical that a few attorneys-at-law specialised in this matter represent the consumers in a very large number of cases related to foreign currency-denominated loan contracts.

[13] See the memorandum of the meeting on 18-19 May 2015 (published in the issue of 2015/7 of BH); the memorandum of the meeting on 28 September 2015 (published in the issue of 2016/1 of BH), the memorandum of the meeting on 9-10 November 2015 (published in the issue of 2016/1 of BH), and the memorandum of the meeting on 16 March 2016 (published in the issue of 2016/6 of BH).

[14] See the memorandum of the meeting held on 22, 23 and 29 June 2015 (available on the website of Curia), the memorandum of the meeting held on 8 June 2016 (available on the website of Curia), the memorandum of the meeting held on 28 September 2016 (available on the website of Curia), the memorandum of the meeting held on 9 November 2016, and the memorandum of the meeting held on 11 October 2018. All memoranda are available on the website of Curia: https://kuria-birosag.hu/hu/konz-ervenytelensegi

[15] For more details see point 5.2.2.

Their legal arguments are related to specific topics and formulaic without knowing and referring to the specificities of the given contract and the concrete contracting process.

It is very regrettable that only a few legal proceedings of public interest have been initiated. Neither the prosecutor's office, nor the – sometimes really loud – interest representation organisations acting for the consumers taking out foreign currency loans are active in this type of legal proceedings, albeit the most efficient consumer protection could be ensured by actions of public interest and the burden on the justice system would also be much smaller. This is well evidenced by the experience gained from the litigations initiated on the basis of the DH1 Act.

2. Concepts often arising in legal disputes concerning foreign currency loan contracts and their legal interpretation by the judges

2. 1. The concept of foreign currency-denominated loan contract

Foreign currency-denominated lending became prominent in the period between 2004 and 2008 so that the legal rules for the legal instrument were quite imperfect. This is well reflected by the fact that the concept and substantial characteristics of foreign currency-denominated loan contracts were not clearly specified by an act. Therefore, the Curia had to define the distinctive characteristics of foreign currency-denominated loans and decide whether is is actually a Forint or a foreign currency loan.

In its decision PJE 6/2013, the Curia clearly took the view that only loans where the money debt is imposed in a currency other than Forint are considered as foreign currency loans. Thus, the Curia made it clear that a foreign currency-denominated loan contract is a foreign currency contracts and not Forint-denominated loan contract with a clause on stability of value.

There had been no uniform judicial practice in this matter before this PJE Decision. Typically, the decrees of the Court of Appeal of Szeged contained the strong argument that a foreign currency-denominated contract is actually a Forint contract.[16] This position was seemed to be confirmed by the fact that the disbursement and the repayment of the loan was done in the Forint since the borrower wanted to satisfy his financing needs arising in Forint by means of the loan. However, the undisputed fact that the borrowers had to pay a more beneficial foreign currency interest rate rather than the relatively high Forint interest rate in the given period clearly justifies, in our opinion, the pertinence of the legal position taken by PJE. Nevertheless, the borrowers had to be reminded in several judgements of the simple fact that the interest rate in the loan contracts was not the same as the interest rate on the financial markets, but was fixed together with a spread. Therefore, this contractual interest rate was significantly higher than the interest rate of the given currency on the financial markets, taking into account the risk factors included in the interest rate.

[16] For instance, in its judgement no. Gf.I.30244/2012/4, the Court of Appeal of Szeged pointed out that the contract covers a loan accounted in a foreign currency where there is no financial movement in any foreign currency but the actual foreign currency exchange rate only serves as the basis of accounting. Therefore, the foreign currency-denominated loan is a Forint loan with a clause on value stability: the borrower always needs to repay his debt in the Forint by converting the amount by using the actual foreign currency exchange rate.

Another frequent argument is that the foreign currency-denominated loans are Forint loans because there was no foreign currency behind the specific loan contract or, at least, the financial institution had to justify that there was a foreign currency behind the transaction. This reasoning is still present in the litigations nowadays. Therefore, it was of great importance that PJE Decision 6/2013 PJE confirmed that there was a foreign currency source behind the loan, taking into account the rules of public law nature concerning financial institutions. Nevertheless, it should not and cannot be examined whether there is a foreign currency source behind a specific loan contract.

The PJE Decision 6/2013 clearly stated that there were two types of foreign currency loans: loans with no effectivity clause (foreign currency-denominated loans) and foreign currency loans with an effectivity clause. The difference between the two categories was defined as follows: "*in the case of a foreign currency-denominated loan, the debt is denominated in a foreign currency the lender must disburse the loan in the Forint and the borrower must repay the loan in the Forint, so both the lender and the borrower must pay in the Forint the money debt imposed in a foreign currency.*" However, if both the disbursement and repayment are done in a foreign currency, the contact is not foreign currency-denominated, but a foreign currency loan contract with an effectivity clause.

Based on the definition above, typically foreign currency-denominated loan contracts were at issue in the cases brought before the courts. Nevertheless, we also met with contractual provisions that were clearly considered as foreign currency loan contracts with an effectivity clause. Finally, contracts were also involved in the court cases, probably in a number higher than the clean-cut foreign currency contracts, where the contractual provisions obliged the borrowers to repay their debt in the foreign currency. However, if they did not comply with this obligation, the lender was allowed to collect the instalment from the Forint account of the borrower.

There are no more points of law to be described in the case of foreign currency loan contracts with an effectivity clause (e.g. use of a two-level foreign currency exchange rate). Nevertheless, it is clear that the effects of exchange rate fluctuations are borne by the borrower also in the case of this contract type in the typical case where their income did not incur in the specific foreign currency.

2. 2. The concepts of consumer, consumer contract and the delineation of the latter from non-consumer contracts

When deciding a legal dispute in legal proceedings, the fact whether a specific loan contract is considered a consumer loan contract may have a decisive importance. As the Curia pointed out in point 1 of the PK Opinion 2/2011, the court has to notice *ex officio* whether a legal relationship involved in the litigation is considered a consumer contract.

In the case of foreign currency-denominated loan contracts, the fact whether the contract being the subject-matter of the legal dispute is considered a consumer contract is of fundamental importance, as other provisions of substantive and procedural law apply to consumer respectively non-consumer loan contracts. For instance, the invalidity or severability of a consumer contract has different legal consequences, taking into account certain provisions of the Old Civil Code, which will be detailed later. The judging of the unfairness of the provisions of consumer contracts is governed by the provisions of European Union law, so we must also take into note the case law of the CJEU. The DH1, DH2 and DH3 Acts[17] (hereinafter jointly referred to as "DH Acts"), as well as the Curia's guidelines of principles previously referred to lay down specific provisions concerning consumer loan contracts, too.

Therefore, in the case of doubt, the courts have to primarily take position on the issue whether or not the specific contract is considered a consumer contract. Taking position on this issue is not easy since the relevant legal provisions define the concept of 'consumer' differently. In addition, due account is to be taken of the EU rules and the case-law of the CJEU when answering this question.

Point d) of Section 685 of the Old Civil Code[18], effective from 1 July 2003, did not narrow down the concept of 'consumer' to natural persons acting for purposes outside their trade, business or operation. The Old CIA had defined the concept of 'consumer' only as of 1 September 2008.[19] It had caused further difficulties in legal interpretation that point a) of Section 2 of Act CLV of 1997 on Consumer Protection, in effect during this period, as well as point a) of Section 2 of Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices against Consumers, had applied different concepts for consumers.

The concept of 'consumer' is also defined differently by the EU directives.[20] Nevertheless, it can be concluded that, in absence of a uniform definition, the judgements of the CJEU have always interpreted the concept of 'consumer' for the purposes of the specific consumer protection legislation.

In the case of contracts with a financial subject, the Hungarian judicial practice adopted the legal position that, as a general rule, a consumer can only be a natural person, taking into account the prior evolution of law, EU law and the case-law of the CJEU. Because if a legal person operating for economic purposes, typically a business association or a cooperative concludes a loan contract then it does so within the scope of its economic or professional activity. So, the Hungarian judicial practice has not accepted the minority position that a company may also be a consumer. Nevertheless, the relevant legal framework would have indisputably allowed a broader interpretation until the amendment of the Old CIA.

On this basis, the Curia does not consider as consumer a company limited by shares with high a share capital or an unlimited or a limited partnership with a few thousand Forints of assets, either. The Curia does not attach decisive importance to the activities undertaken by the company or the categories of activities (pursuant to TEÁOR numbers) listed in its memo-

17 Act LXXVII of 2014 on Settling Certain Issues Related to the Conversion of the Currency of Certain Consumer Loan Agreements and to the Rules Governing Interest Rates (hereinafter referred to as "DH3 Act")

18 Pursuant to point d) of Section 685 of the Old Civil Code: *"Consumer means a person concluding a contract with an aim falling outside of the scope of his/her economic or professional activity."*

19 Pursuant to point III.4 of Annex 2 of the Old CIA *"consumer means a natural person pursuing activities to achieve goals outside the scope of their own profession and economic activity."*

20 Pursuant to Article 2 of Directive 93/13/EEC on unfair terms in consumer contracts (hereinafter referred to as "Consumer Directive"), which is the most frequently cited and applied directive one in relation to foreign currency-denominated loan contracts, 'consumer' means *"any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession."*

randum of association. Hence, the Curia does not consider non-natural persons established for economic purposes as consumers. The lower level courts typically follow this practice.

If a natural person enters into a loan contract, the judicial practice attaches importance to the fact whether the natural person in question concluded the contract with an aim falling outside of the scope of his/her economic or professional activity, based on the wording of the Old Civil Code. In addition, the Curia regards the concept of the Old CIA, effective as of 1 September 2008, as guiding, namely, it examines whether the natural person concluded the contract to achieve goals outside the scope of his own profession and economic activity. The fact that the two legal acts referred to use different concepts did not cause any difficulties.

Often, the loan contract taken by a business association was complemented by loan contracts made by the various members or executive officers of the company with the aim of using it for corporate purposes or securing the loan taken out by the company. Even though these contracts were concluded by natural persons, they are not regarded as consumer contracts since the clearly identifiable aim of the contracts is to support the economic activity of the corporate body.

It was raised as a question that if, in a loan contract without a specific purpose of use, one co-debtor is a company and the other co-debtor is a natural person who is not a member or executive officer of the company can the contract be regarded as a consumer contract with regard to the latter person? According to the uniform position a contract cannot be regarded as a consumer and a non-consumer contract at the same time. In this case, as a rule, if one of the borrowers is not a natural person the contract is coherently not regarded as a consumer contract.[21]

If the same natural person concludes contracts for different purposes, it is possible that this person is regarded as a consumer and the contract made is regarded as a consumer contract in respect of one of the purposes while it is not regarded as such in respect of others.

The practice of the Curia attaches importance to the information related to the purpose of loan and the person of borrower the lender came to know during the preparation for contracting or, at latest, upon the conclusion of the loan contract. Namely, the purpose of the loan has key importance in the determination of consumer nature. If the purpose is to support the objective of a sole proprietorship (e.g. purchase of commercial premises or a vehicle, e.g., a van, for the business), then a non-consumer contract is made. Loan substitution as a loan purpose does not change the purpose of the loan. So, if the original contract was not concluded as a loan contract for consumer purposes then the substituting contract cannot be a consumer contract, either. This is also true *vice versa*: if the original loan contract was concluded for a consumer or personal purpose, the substituting contract is also regarded as such.[22] If the registration number of the sole proprietorship is indicated on the data sheet related to the loan request or in the contract itself, then the contract cannot be regarded as a consumer contract, either. A loan taken out for purchasing a business share in a limited liability company is not a consumer contract, either. The loan purpose cannot be regarded as independent from the economic activity even if the borrower does not intend to participate in the activities of the limited liability company and the business share does not produce income for him.[23]

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21 See: point 2 of the memorandum of 9 November 2016.

22 BH 2016/4/83

23 Economic decision of principle G.1. of 2015.

Nevertheless, based on the practice of the Curia, it has no relevance if the borrower later proves in the legal proceedings that the loan taken out was not used for the purposes known at the conclusion of the contract, whether in whole or part (e.g. renovation of his house). This will not make the contract a consumer contract.[24] It does not change the consumer nature of the contract, either, if it is proven later in the legal proceedings that the loan provided to the natural person with no attached purpose was used for his sole proprietorship. It also has no relevance if the vehicle purchased from the loan provided for entrepreneurial purposes was not shown in the asset inventory of the borrower's sole proprietorship or if the sole proprietorship ceased to exist during the repayment period.

Based on the unambiguous practice of the Curia, the nature of the contract is fixed at the time of contract is concluded, by taking into account the data known to the lender at that moment. The pertinence of this legal position is also justified by the fact that the lender had to act in a different way and had extra obligations when it concluded consumer loan contracts. Facts that have become known later do not influence the consumer or non-consumer nature of a specific contract.

2. 3. The concept of consumer or personal loan

In addition to clarifying whether a consumer contract was established, it also has to be examined in the disputes concerning foreign currency-denominated loan contracts in litigations based on Section 213 of the Old CIA repealed effective of 11 June 2010, whether a consumer or a personal loan contract was made, as well as if such a contract qualified as a consumer or persona loan contract.[25]

Based on the relevant provisions of the Old CIA, it is obvious that a contract is a consumer or personal loan only if the contract is a consumer contract. However, qualifying the contract as a consumer contract is to no avail if the loan is granted for purchasing assets that cannot be regarded as consumer goods primarily used for personal purposes (e.g. purchase of a yacht) The judicial practice recognizes vehicles of average value as consumer goods primarily used for personal purposes. Luxury or premium category vehicles are not regarded as such by the judicial practice.

Although such a concrete issue of legal interpretation has not arisen yet, we believe that the distinction to consumer loan contracts cannot be applied to personal loans, taking into account their legal definition. Therefore, a loan granted to a natural person for non-economic purposes, with the aim of purchasing a real estate of really high value is regarded as a consumer or personal loan.

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24 BH 2015/7/197, as well as judgement no. Gfv.VII.30716/17 of the Curia

25 Between 1 January 1998 and 31 August 2008, the concept of 'consumer loan' was defined in point III.5 of Schedule 2 of the Old CIA as follows: *"consumer loan means a loan granted to a natural person for the purchasing or repair of consumer goods primarily used for personal, family or household purposes, or for using services, without making such loan attached to a specific purpose of use, and if such loan is borrowed by the natural person not as part of his business activity."* This provision was modified due to the legal regulation of the concept of consumer.

Between 1 January 2001 and 10 June 2010, the concept of personal loan was defined in point III.13 of Schedule 2 of the Old CIA: *"personal loan means a consumer loan or other loan that can be used by a natural person for purchasing, building, renovating, enlarging or remodelling homes, vacation homes or other real property and for upgrading public utilities."*

2. 4. Complexity of interests of the parties

An interesting conclusion can be drawn from the experience gained in legal proceedings. Many entities clearly not considered as consumers claimed that the contract concluded by them is a consumer contract (consumer or personal loan contract). This happened primarily so that they can refer to the nullity of the contract and that EU law, the case-law of the CJEU, the guidelines of principle issued by the Curia on this subject-matter, as well as certain provisions of DH Acts also apply to them.

However, a reverse trend could also be observed. In the case of consumer contracts clearly concluded by consumers, it was argued that the specific contract was not a consumer contract or the specific contractual provisions were individually negotiated. In this way, they wanted to be exempted from suspending the proceedings pursuant to Section 16 of the DH1 Act and applying the rules laid down in Sections 37 and 37/A of the DH2 Act.

3. The issue of the non-conclusion of contracts

The parties started to argue in legal proceedings that the contract had not been concluded primarily after the entry into force of the DH2 Act. Presumably this is related to the fact that the provisions of Section 37 of the DH2 Act no longer applies to non-concluded contracts. In this case, unless otherwise provided by the law, an action for declaratory judgement only may also be brought before the court pursuant to Section 239/A of the Old Civil Code and the legislation does not even exclude the restoration of the original situation. However, it is not clarified yet whether the restoration of the original situation is possible at all and what it precisely means.[26]

With regard to the non-conclusion of the contract, the borrowers refer to reasons of form on the one hand and reasons of substance on the other hand.

3. 1. Non-conclusion of contracts for reasons of form

Pursuant to Section 210 (1) of the Old CIA, financial institutions were allowed to conclude loan contracts only in writing or in the form of an electronic document executed with a qualified electronic signature. We have not met any case where this requirement was violated. The provision in question also required that the customer be provided with one original copy of the contract. Based on this, the failure to deliver the general terms and conditions that formed a part of the contract could not result in the non-conclusion of the contract.

It was typically referred to as a formal deficiency that the person signing the loan contract on behalf of the lender had not had a valid power of representation or that the parties had not been duly signed.

Related to this argumentation, it had to be pointed out in the legal proceedings that the form and methods of signing authority are indisputably regulated in Section 8 of Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings (hereinafter referred to as "CPA") and Section 29 (3) of Act IV of 2006 on Business Associations (hereinafter referred to as "CA"). These provisions were complemented by Section 47 (2) of the Old CIA, which stipulated a joint right to sign under the conditions

26 See the summary opinion drafted by the legal practice analysing group on the legal consequences of invalidity.

specified therein. These legal provisions did not exclude that the persons authorized to sign for the company delegate their power of representation by a power of attorney.

Consequently, the loan contract was concluded even if the contract was concluded the purchaser of vehicle by the car dealer company on behalf of the financial institution. It was unambiguously declared in the decision of principle no. P2 of 2016 that the financial institution could validly establish a transactional right of representation in the mandate contract concluded with the car dealer undertaking to authorize the car dealer company to conclude a loan contract on behalf of the financial institution simultaneously with concluding the sales contract when the the vehicle was sold. And the car dealer company

could lawfully authorize its employees to conclude the loan contract. This authorization could take the form of a formal authorization in writing, but it should also be considered as valid if the authorization was included in the job description of the employee concerned. The decision also stipulated that the chain verifying the creation of the power of representation did not have to be manifest from the contract itself.

It happened that the employee of car dealer had signed the contract on behalf of the financial institution but the above chain was not proven and the employee did not hold an authorization from the financial institution that was legally valid pursuant to the Old Civil Code In such a case, the signatory of the contract acted as an unauthorised representative whose action could be approved by the financial institution subsequently both prior or during to the legal proceedings, taking into account the provisions in Section 221 of the Old Civil Code. The approval is not bound by formalities so the represented person could make his/her statement on the approval of the unauthorised representative's action orally, in writing or even by conduct.[27] The Curia published a decision,[28] in which it stated that the contract had already been approved implicitly already when, based on the provisions of the contract, the financial institution had disbursed the loan amount to the borrower.

Although it does not concern the non-conclusion of the contract, it might be worth pointing out here that frequent references were made to the fact that the general terms and conditions forming a part of the contract (hereinafter referred to as "GTC") were not signed by the consumer and, therefore, he was not bound by the provisions therein. In this subject-matter, the Curia has clearly taken the view that the borrower does not have to separately sign the GTC, forming a part of the contract (also including the business code and the notice), in order for it to become a part of the contract. The CJEU has confirmed this legal interpretation in case no. C-42/15 Home Credit Slovakia a.s. It held that the loan agreement does not necessarily have to be included in one piece of document, and the parties are required to sign all the documents if this is explicitly stipulated by national law.

3. 2. Non-conclusion of contracts for reasons of substance

The borrowers have also frequently referred to reasons of substance as reasons for the non-conclusion of the contracts.

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[27] BH 2014/10/303

[28] BH 2016/4/83

Pursuant to Section 205 (1) of the Old Civil Code, it is fundamental to the validity of a contract that an agreement is reached by the parties concerning all essential issues, as well as those deemed essential by either of the parties. Pursuant to Section 210 (2) of the Old CIA, the agreement for financial services and auxiliary financial services must clearly indicate the interest rate, the fee and all other charges and conditions, including the legal consequences of late payment, and the method and consequences of enforcing the collateral obligations made to secure the contract.

According to the legal practice of the Curia, a foreign currency-denominated loan contract is not concluded owing to deficiencies of substance if it does not contain the loan amount, the loan currency, the interest (although there are differing opinions in this regard) and the tenor.

As the Curia has pointed in point II.1.a) of its PJE Decision 1/2016, there are two typical methods to determine the loan amount in the case of foreign currency-denominated loan contracts. One method is that the loan amount is determined in a foreign currency and it followed from other contractual provisions that the foreign currency defined in the contract had to be converted to the Forint at a specific time by using the foreign exchange rate stipulated therein, and that this loan amount had to be disbursed and repaid in the Forint. The other method of determination is that the loan amount is defined in the Forint but, based on the other contractual provisions, it was clear that the loan is determined, recorded and accounted in the foreign currency at the time specified in the contract, by taking into account the foreign exchange rate stipulated therein.

These were the methods of determination considered as typical. Some financial institutions applied solutions where, although the loan amount had been fixed in the contract in the foreign currency, the maximum amount to be disbursed had also specified in the Forint, thus adjusting to the borrower's loan need arising in the Forint. After concluding the contract, the loan was disbursed and the loan amount was fixed in the foreign currency by taking into account the foreign exchange rate valid on that day. Thus, the design was indisputably complex.

Generally, it can be said that the loan amount could be determined in any way by which the amount of money to be made available at the time of performance of the contract could be determined.[29]

In many of its decisions,[30] the Curia pointed out that the non-conclusion of a contract cannot be established if the borrower had received the loan amount, had not objected to it, started to fulfil his repayment obligations and referred to the non-conclusion of the contract due to the inaccurate and unclear determination of the loan amount only years later.

Nevertheless, these legal arguments were cited in the legal proceedings not in regards to the non-conclusion of the contract but as a reason for the contract being null and void based on point a) of Section 213 (1) of the Old CIA. On the other hand, the issue of the unfairness of these contractual provisions has also been raised. In this regard, the CJEU explained in its order in case no. C-126/17 Erste Bank Hungary Zrt. that the contractual provision is not unfair if it fulfils the requirement of plainness and intelligibility.

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29 See point I/2 of the memorandum of 28 September 2016.

30 E.g. BH 2018/8/230, as well as decision no. Gfv.VII.30559/2017/4. of the Curia (expected to be published in BH).

Based on Section 523 (2) of the Old Civil Code, borrowers shall pay interest if the creditor is a financial institution, unless otherwise provided by the law. The interest could be determined as an absolute amount or by using an annual percentage. The contract was surely concluded no matter which method had been used to determine the interest. It is another issue that, pursuant to point c) of Section 213 (1) of the Old CIA, the loan contract became null and void in case the interest was not expressed as a percentage. In case the interest rate was not determined, the provisions laid down in Sections 232 (1) and (2) of the Old Civil Code could nevertheless apply (although the legal position above could be debated).[31] If we accept this position then the contract is invalid (null and void) based on point c) of Section 213 (1) of the CIA even though it was concluded. No such case has come up in the practice of the Curia.

In the practice, there were no contracts where the currency or the tenor (the latter in a calculable way) were not determined, so establishing the non-conclusion of the contract for that reason has never occurred.

The lack of any other substantial elements listed in Section 210 (2) and Section 213 (1) of the Old CIA does not result in the non-conclusion of a contract.

4. Nullity (partial nullity) of the contract due to violation of law or evident contradiction to good morals

4. 1. Grounds for invalidity resolved by PJE Decision 6/2013

It had been a frequent argument before the PJE Decision 6/2013 was adopted that the foreign currency-denominated loan contracts are evidently in contradiction to good morals, were usury contracts, aimed at impossible services or were fictitious contracts. The Curia clearly and explicitly articulated its position on these issues in point 2 of the PJE Decision 6/2013, namely, that arguments referring to the above grounds were not correct, hence the contracts made were not null and void in the absence of specific factual elements. The judicial uniformity decision also pointed out that, with the exception of investment loans, foreign currency-denominated loans did not have an investment purpose, hence the EU rules concerning investment loans and the provisions for information stipulated therein did not apply to them. The above legal position was confirmed in CJEU case no. C-312/2014 Banif Plus Bank Zrt. We do not explicitly return to the arguments detailed in the PJE Decision in this study.

4. 2. Potential legal consequence of violating certain provisions of the Old CIA

4.2.1. Violation of Section 210 (2) of the Old CIA

Pursuant to Section 210 (2) of the Old CIA, a loan contract must clearly state the interest rates, the fee and all other charges and conditions, including the legal consequences of late payment, and the method and consequences of the enforcement of collateral obligations securing the contract. These legal provisions are typically referred to in cases involving contracts other than consumer loan or consumer leasing contracts, since these contracts do not fall within the scope of the provisions of Section 213 (1) of the Old CIA.

31 See point I/2 of the memorandum of 28 September 2016.

In the case of a loan contract, the lack of determination of the interest rate (if this was not even included in the contract in a calculable way) results in the non-conclusion or nullity of the contract.[32]

Contrary to Section 213 (1) of the Old CIA, this Section did not require the determination of the annual percentage of the interest. However, in order to be able to charge the fees and other costs on the top of the interest rate, it is necessary that they are defined in the contract or the annexes forming a part thereof. Nevertheless, the lack of these does not result in the nullity of the contract.

In the case of financial leasing contracts, the borrowers frequently refer to the violation of Section 210 (2) of the Old CIA, namely, that the interest rate was not defined in the contract at all or as an annual percentage.

Based on the concept of financial leasing,[33] the Curia held that the interest forming a part of the leasing fee is not identical with the interest stipulated in point III/7 of Schedule 2 of the Old CIA[34] As defined therein, the interest means sum of money or other yield payable for the use of and risks associated with the loan determined as a percentage of the loan amount and for a specific period of time. Even though the contract also has a loan element, the interest part of the leasing fee is consideration for using the asset for a specific period of time or, where a residual value is specified, the consideration for transferring the title. Therefore, the Curia concluded that the provisions concerning the determination of the interest in Section 210 (2) of the Old CIA apply to financial leasing contracts *mutatis mutandis.* In fact, the interest part is in the contracts being the subject of the legal proceedings was determined in absolute terms and in a calculable way, so the Curia decided so that these contracts had not violated the provisions of Section 210 (2) of the Old CIA and, thus, were not null and void.

4.2.2. Assessment of the grounds for nullity in violation of Section 213 (1) of the Old CIA

It was frequently referred to in the legal proceedings that a specific consumer loan contract was null an void for grounds set out in Section 213 (1) of the Old CIA.

It is important to emphasize that the provisions in Section 213 (1) of the Old CIA applied only to consumer or personal loan contract (see point II.3.).

By referring to the wording of Section 213 (1) of the Old CIA, the consumers frequently argued that violating any of the provisions included therein resulted in the nullity of the contract as a whole since this was suggested by the wording of the legal provision. Having

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32 See point III.2.

33 Pursuant to point I/11 of Schedule 2 of the Old CIA, financial leasing means an operation where the lessor acquires the title to a real or movable property or a right representing assets under the assignment of the lessee for the purpose of conferring the right of the use of such asset to lessee for a specified period of time, provided, that it is shown in the lessee's books. In addition to other rights and obligations, upon assignment of use the lessee acquired the right that it or a third party designated by it acquires the title to the leased asset upon the expiry of the lease period stipulated in the contract and subject to the payment of principal and interests of the leasing fee in full and, if included in the contract, the residual value. The parties shall stipulate in the contract the principal part of the leasing fee, which equals the contract price of the leased asset or right representing assets and the interest part of leasing fee and the repayment schedule.

34 BH 2017/4/125

carefully examined the relevant provisions, the legal consequence of absolute nullity exists in only a few cases. Because if the reason for invalidity is a deficiency of the content in the absence of which the contract can be performed then the contract is only partially invalid.

Pursuant to point a) of Section 213 (1) of the Old CIA, a consumer or personal loan contract is null and void if it does not include the object of the contract. The interpretation of this provision is supported by that Article 4 (4) of Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit was transposed into the Old CIA. Pursuant to the Directive, *"the written agreement shall further include the other essential terms of the contract."*

In the case of a loan contract, the determination of the loan amount, the tenor and the transactional interest rate constitutes the essential terms of the contract. In the case of a foreign currency-denominated loan contract, it is further required that the contract includes the currency in which the debt is imposed. As the Curia pointed out in its PJ Decision 1/2016, the determination of the date of conversion is not a validity requirement of the contract since it is *ipso iure* fixed on the day of disbursement pursuant to Section 230 (2) of the Old Civil Code, unless otherwise provided in the contract. And the legislator regulated the issue of the guiding currency exchange rate in the DH1 Act. It is not a validity requirement that the contract includes the loan amount calculated in the foreign currency where the loan amount is specified in the Forint, respectively the loan amount specified in Forint where the loan amount is specified in the foreign currency, by applying the relevant foreign currency exchange rate on the given day. No case was brought before the Curia, where the contract did not include the currency in which the debt was imposed.

Pursuant to point b) Section 213 (1) of the Old CIA, a consumer or personal loan contract is null and void if it does not include the annual percentage rate expressed as a percentage (hereinafter referred to as "APR") and the definition and amount of any other costs that were not taken into consideration when calculating the APR or, if such costs cannot be precisely defined, an estimate thereof. A contract is invalid if it does not contain the APR or its annual rate in percentage. The absence of the determination the percentage of the APR alone results in the invalidity of the contract, but if it is a formal deficiency only, the contract may be declared valid.[35]

It is a different issue and causes nullity pursuant to point b) of Section 213 (1) of the Old CIA, if the APR was indicated in the contract in a deceptive manner that caused or was likely to cause the consumer to make a transactional decision that he would not have made otherwise (judgement no. C-453/10 Perenovica and Perenic of the CJEU).

The contract as a whole will not be null and void due to the deficiency of content mentioned in point b). Nevertheless, if these costs (or an estimation thereof) are not defined in the contract, the legal consequence is that these costs may be ignored when calculating the APR and the financial institution may not lawfully charge them.

Pursuant to point c) of Section 213 (1) of the Old CIA, a consumer or personal loan contract is null and void if it does not include all the cost related to the contract, including interests, commissions and the values thereof expressed as percentage.

[35] Judgements no. Pfv.VI. 20.967/2015., Pfv.I. 22.111/2015., point 2 of the memorandum of 28 September 2016

The interest in the loan contracts made by the credit institutions consists of the reference interest and an interest premium. In this regard, there are two typical methods of defining the interest in the contracts. In certain contracts, the reference interest (e.g. 3-month CHF LIBOR) and the interest premium were indicated separately and the aggregated of these two amounted to the annual percentage rate of the interest. In the other case, only one interest rate was included in the contract.[36] (A change in the reference interest indicated in the contract cannot be regarded as an unfair contract term).

In case the interest is not included in the contract in a calculable way and the annual percentage rate of the interest is not included in the contract, either, then the contract is null and void but the conditions for declaring the contract valid are fulfilled.[37]

Nevertheless, it does not result in the nullity of the contract if, in addition to the interest, the contract does not contain the default interest, costs and their annual percentage rate. Costs not included in the contract may not be charged. If this still happens, they are charged without a legal basis and must be ignored in the accounting between the parties. Because there is no legal provision that requires or makes it presumable that the parties have agreed on the payment of these costs. If a specific cost is included in the contract, but not as an annual percentage, this results in the nullity of the relevant provisions of the contract or, eventually, the unfairness thereof where the service for which it is the compensation cannot be established.[38]

Pursuant to point d) of Section 213 (1) of the Old CIA, a consumer and personal loan contract is null and void if it does not include a detailed description of the conditions and circumstances under which the annual percentage rate may be varied or, if this is not possible, information concerning such. It is obvious that a contractual provision in violation of point d) does not cause the nullity of the contract as a whole, but only results in the that the contractual provision concerning the modification of the annual percentage rate cannot be applied, i.e. the annual percentage rate shown in the contract becomes fixed. This provision does not have a practical importance any longer, having regard to Section 4 of the DH1 Act and the legal proceedings conducted thereafter. All unilateral contractual provisions allowing changing the interests, costs and fees unilaterally to the detriment of the consumers were, without exception, deemed unfair pursuant to the Act in question on the one hand and the provisions of the final judgements delivered by applying the procedure required by this Act on the other hand.

Based on judicial practice, a specific contractual provision is null and void pursuant to the provision of the Old CIA in question if it does not contain the list of grounds. If the contract contains the list of grounds but in a way that does not fully comply with point 6 of the PK Opinion 2/2012 and the principles laid down on the PJE Decision 2/2014, then the provision of the CIA in question is not violated, but the contractual provision is unfair.[39]

Pursuant to point e) of Section 213 (1) of the Old CIA, a consumer or personal loan contract is null and void if it does not include the number and amount of instalments and the repayment dates. As explained in point IV.2 of the PJE Decision 1/2016, the contract is

[36] BH 2017/2/64
[37] See point VII.3.
[38] See point V.3.2.
[39] BH 2016/4/83

not null and void if the amount of the instalments is not included in the contract, but it is calculable. The dates of instalment payments cannot be determined only by indicating a specific calendar day, but also by defining them in other clear ways.

Pursuant to point f) of Section 213 (1) of the Old CIA, a consumer and personal loan contract is null and void if it does not include a description of the required security. This legal provision only means that if a security has not been stipulated at all or clearly, then it may not be enforced.

4.2.3. Contracts concluded without a licence

In certain cases, the first instance courts attached importance to the issue whether a car dealer had acted as an agent for the lender pursuant to sub-point a) or b) of point I.12 of Schedule 2 of the Old CIA. In this context, the question has also arisen whether the car dealer has fulfilled the notification or licensing requirements required for acting as an agent. In the absence of the necessary licence, the nullity of a contract was established.

The Court of Appeal of Szeged and, later, the Curia clearly took the position in many legal proceedings that the above circumstances should not be examined since they cannot cause the nullity of a contract. According to settled judicial practice, a contract in violation of the rules of other branches of law is invalid from a civil law perspective if the act of the other branch of law explicitly stipulates that the violation of the specific legal norm also results in the invalidity of the contract. The Old CIA required a licence from the financial supervision for pursuing activities for providing certain financial services, however, it did not attach the legal consequence of invalidity to legal transactions concluded in the absence of a licence.[40]

5. Nullity or partial nullity of a contract where unfair contract terms were applied

It is also frequent in legal proceedings that reference is made not only to a violation of the law, but also the unfairness of certain contractual provisions.

There is a multi-layered regulation concerning unfair contractual clauses. Until 1 March 2006, the Hungarian regulation was based on Sections 209–209/D and, later, Sections 209–209/B of the Old Civil Code. This regulation was complemented by Government Decree 18/1999. (II. 5.) on Unfair Terms in Consumer Contracts (hereinafter referred to as "Government Decree"), which was in effect until 15 March 2014. In addition to the Hungarian legal framework, Union law, in particular certain provisions of the consumer directive, as well as the case-law of the CJEU are of paramount importance. Several Hungarian and other Member State courts initiated preliminary ruling proceedings in this subject matter, and the judgements delivered in these proceedings helped develop a uniform legal interpretation and practice. Out of the Hungarian initiatives, the most significant ones are probably the judgement no. 26/13 adopted in the Kásler case (hereinafter referred to as "Kásler Case"), the judgement no. 483/16 in the Sziber case (hereinafter referred to as "Sziber Case"), the and judgement no. C-51/17 in the Ilyés case (hereinafter referred to as "Ilyés Case"). Of the

40 Civil decision of principle no. P.2. of 2016.

foreign inquiries, the judgement no. C-186/16 delivered in the Andriciuc case (hereinafter referred to as “Andriciuc Case”) can be considered the most relevant.

The unfairness of the specific contractual provisions can only be examined only with regard to general terms and conditions and, in the case of consumer contracts, contractual provisions that were not individually negotiated. Examining unfairness is of paramount importance in the case of loan contracts concluded by financial institutions because one of the substantive characteristics of these contracts is that their provisions have not been individually negotiated. In the case of contracts concluded in great numbers for the same purpose, except for certain contractual provisions to be individually negotiated, the contracts are drafted by the financial institutions in advance for the purposes of concluding more contracts, i.e. blank contracts are concluded. Thus, the loan contract consists of individually negotiated sections on the one hand and parts that are not individually negotiated on the other hand.

It is also typical that the general terms and conditions drafted by the lender, but not individually negotiated by the parties are annexed to the contract signed by the parties. It is important to emphasize that, as laid down in point III.1. b) of the PJE Decision 1/2016, the business code and the notice defined in Section 203 of the Old CIA are also regarded as GTC (hereinafter referred to as “GTC”). The contract signed by the parties and the GTC, which is typically not signed by the parties, jointly constitute the agreement of the parties.

5. 1. Exclusion of the examination of unfair contract terms

A general contractual term or, in the case of consumer contracts, a contract term that is not individually negotiated cannot be considered unfair if it is laid down by the law or determined in accordance with the requirements of the law. So, the unfairness of such conditions cannot be examined. (This rule appeared in Section 209/B and, later, Sections 209/B (5) and (6) of the old Civil Code).

The legal provision described was interpreted in point 3 of the PK Opinion 2/2012 in a way that this provision does not apply to legal provisions that are of a “framework nature”, i.e. they only apply in case the legal provisions are filled with content in the contract (e.g. a legal provision allowing unilateral contract amendments detrimental to the consumers should be regarded as such). This legal interpretation is consistent with the case-law of the CJEU, according to which the unfairness of contractual provisions cannot be examined that apply irrespective of the choice of the contracting parties or apply automatically, i.e. unless the parties agree otherwise.[41]

Referring to this legal interpretation, the Curia did not consider possible to examine the unfairness of a contractual provision literally[42] or almost literally complying with the provisions in Section 261 (2) of the Old Civil Code, irrespective of whether the provisions of the Old Civil Code in question had elements that required interpretation (when can the satisfaction of a claim be considered to be in jeopardy or what is considered as an adequate security corresponding to the degree of the jeopardy). The Curia pointed out that, based on Section 205 (2) of the Old Civil Code, this legal provision becomes a part of the content of

41 Point 26 of CJEU judgement no. C-92/11 delivered in case RWE Vertieb AG.

42 *„If the deterioration in the condition of the pledged property endangers the satisfaction of the claim the pledgee may claim that the pledged property is restored or adequate security corresponding to the degree of jeopardy is provided.”*

the contract unless the parties agree otherwise. The unfairness of the contractual provision could be examined only if it had complemented the legal provisions.[43]

Notwithstanding the above, the Curia found that the unfairness of the contractual provision that regulated the conditions of sale out of judicial execution may be examined, and did establish the unfairness thereof. The Curia also pointed out that provisions of Section 257 of the Old Civil Code[44] set forth, among others, that the lowest sale price or a formula for calculating the sale price should be defined in the contract. Therefore, this is considered a framework type rule since its content has to be defined by the parties in the contract. The Curia ruled that all contractual provisions were unfair that authorized exclusively the financial institution to select valuers required for determining the lowest sale price in such a way that only persons contracted with the financial institution were allowed to carry out the valuation, without wither the law or the specific contract ensuring an effective remedy. [45]

The unfairness of contractual provisions determining the primary service and the proportion of the service and the counterservice cannot be examined if they are otherwise clear and understandable. It falls within the competence of the national court to decide what qualifies as a contractual provision determining primary service. In its PJE Decision 2/2014, the Curia took the position that the distinctive characteristics of a contract, e.g. the bearing of the exchange rate risk, are considered as such.

5. 2. Legal interpretation issues raised only by foreign currency-denominated contracts

5.2.1. Use of a two-level foreign currency exchange rate

The contractual clause concerning the purchasing and selling exchange rates was declared unfair by the PJE Decision 2/2014, calling upon the points made in the CJEU judgement delivered in the Kásler case. In turn, the DH1 Act abolished these grounds for partial nullity and settled the detriments suffered by the consumers in this context in the context of accounting with the financial institutions.

5.2.2. Bearing of the exchange risk

As explained in point 1 of the PJE Decision 6/2013, one conceptual criterion of the foreign currency-denominated loan contracts is that the exchange risk is borne by the consumers.

Pursuant to the PJE Decision 2/2014, the contract is invalid in this regard only if the fact that the exchange risk is borne by the consumers was not clear or understandable for the average consumer from the contract, the risk assessment declaration or the information provided prior to contracting.[46] The fact whether an average consumer should have been aware of its obligation to pay for the exchange rate change can be determined only by jointly taking into account

[43] Curia judgement no. Gfv.VII.30742/2017/8.

[44] Section 257 (1) of the Old Civil Code provides the following: "*The parties can agree in writing to sell the pledged property together before the claim to which it pertains falls due by establishing the lowest sale price or a formula for calculating the sale price, and a deadline from the date on which the claim falls due.*"

[45] BH 2018/9/256

[46] The clarity and understandability of the contract term should be examined not in relation to the concrete consumer but from the perspective of a reasonably well-informed, reasonably observant and diligent consumer. See point 74 of the judgement in the Kásler case (hereinafter referred to as "average consumer").

several documents and evidence (contract, risk assessment declaration, promotional materials and, potentially, the circumstances of contracting and the witness statements on what was said). While doing so, it must be examined whether, based on the information provided to him in such a way, the average consumer was aware of the fact that the exchange rate change has no upper limits and it should be borne by him without limitation.

Some chambers of the Metropolitan Court of Appeal suggested that the conversion to the Forint introduced by the DH3 Act already excludes the examination of the unfairness of bearing the exchange risk.[47] However, the Conference of the Heads of Civil Divisions, as well as the consultative body of judges presiding over cases involving foreign currency loans has decided, by a majority decision, that the provisions of the DH3 Act on converting the foreign currency loans to the Forint cannot have such a legal effect.[48] One chamber of the Metropolitan Court of Appeal disagreed with this legal position and turned to the CJEU in the Ilyés case. It has, among others, formulated questions about this issue in its request for a preliminary ruling proceeding.

During these proceedings, the CJEU clearly took the position in its judgement delivered on 20 September 2018, that the legal provisions adopted after contracting, hence the DH3 Act, do not exclude the examination of the unfairness of bearing the exchange risk. In its ruling, it has established, among others, that the requesting court should decide on the appropriateness of the information provided on the exchange risks, taking into account the circumstances of a specific case. In doing so, not only the formal but also the grammatical clarity is to be examined (reference to point 44 of the Andriciuc judgement). The information has to cover the effects a serious devaluation of the Member State currency or and an increase of the interest rates can exercise on the instalments.

In the context of the question raised, the CJEU laid down the following requirements concerning information. Consumers should be provided with clear information as to that, by signing the contract, they bear a certain degree of exchange risk, which may become difficult to bear economically (as his income is in a different currency). Attention must be drawn to the potential changes in the exchange rate and the risks related to the loan taken out in a foreign currency (these two requirements are almost literally included in point 50 of the Andriciuc judgement). It must be ensured that the consumer can get to know all contract terms on the basis of information provided timely before the contracting (same as explained in point 70 of the Kásler judgement).

Nevertheless, the provisions in the judgement do not necessarily mean that the information can only be deemed appropriate if it contains calculations on how the consumer's payment obligation develops in the case of certain exchange rates. The CJEU did not impose, either, the requirement that the bank should draw the attention to the escape currency nature of CHF or that the bank should provide information on the likelihood and degree of an exchange rate change detrimental to the consumer. (The latter two would not even have been possible).

We believe the judgement of the CJEU means that the Member State courts should take a position on the issue whether the information provided fully complied with the provisions in the Ilyés judgement by examining the concrete contract and the circumstances of

[47] See decision no. 20.Gpkf. 44.307/2016/2 of the Metropolitan Court of Appeal.

[48] See point 6 of the memorandum of 17 March 2016 and the memorandum of 28 November 2016.

contracting. If the information fulfils the requirements in the judgement of the CJEU and PJE Decision 2/2014, the exchange risk is borne by the consumer.

Nevertheless, there may be some cases when this cannot be established by reasoned conclusion and it cannot either be established,either, based on t he evidence that the consumer agreed to an exchange risk that can be specifically determined. In such a case, it can occur that, according to the judgement of the CJEU, an average consumer was or had to be aware of the exchange risk and the fact that it is borne by him even in the absence of adequate information. At best, he did not receive the required level of information concerning the degree of its occurrence. However, he knew or could know that the foreign currency interest rate is more beneficial than the Forint loan interest rate, which partially compensated for the exchange risk. So, the question may arise whether, in the absence of adequate information, the risk of bearing the exchange risk may be shared between the consumer and the lender and, if yes, in what proportion and by taking account of which aspects. However, if the bearing of the exchange risk cannot be shared between the parties, does this means that the consumers are obliged to meet their contractual obligation at the exchange rate applicable at the time of contracting? If yes, another question is whether, in this case, the consumers are obliged to pay the interest rate stipulated in the contract or the interest rate to be applied to Forint loans.

5. 3. Legal interpretation issues raised not only in relation to foreign currency loan contracts

5.3.1. Unfairness of contractual provisions concerning the unilateral increase of interests, costs and fees

By further developing the provisions in the PK Opinion 2/2012, point 2 of the PJE Decision 2/2014 and the DH1 Act and, subsequently, the legal proceedings initiated with regard to the provisions of this Act have settled this point of law. According to the final judgements delivered in these legal proceedings, none of the contract terms applied by the financial institutions with the above content complied with all the principles laid down in the decisions of principle of the Curia, in particular, the principles of clear and comprehensible wording and transparency.

5.3.2. Unfairness of the contractual provisions concerning administrative costs, commissions and fees

A number of financial institutions stipulated administrative costs on top of the interest, as if to complement it. Similarly to the interest, the administrative cost was also indicated as an annual percentage in the contract, however, without determining in any way the service(s) for which the administrative fee is payable as the consideration.

While the administrative cost had to be paid during the whole tenor, one-off fees were also stipulated. It has not been specified in this respect, either. which services were compensated by these one-time payments although the designation of some of these potentially allowed drawing conclusions (e.g. disbursement commission).

Having explored the differing positions of the courts of appeal in this regard, as well as the differences of the German and Austrian legal interpretation, the Curia deemed it necessary to initiate a preliminary ruling proceeding to clarify the points of law arisen.[49]

The questions raised concern the issue whether the requirement of clear and comprehensible wording outlined in the consumer directive is fulfilled by a contract that precisely defines the amount of the cost, fee and commission to be borne by the consumer, their method of calculation and date of payment, but does not stipulate the services for which the given cost was paid as the consideration. Is it sufficient if the content of the cost can be concluded from its name? Does a provision regarding the costs cause a significant imbalance to the detriment of the consumer, where the specific contract provided in return for the cost cannot be clearly identified based on the contract?

5.3.3. Contractual provision concerning the notarial certification of facts

Many cases were brought before the Curia, in which the unfairness of the contractual provision concerning the certification of facts issued by a notary had to be judged. In this regard, the Curia did not agree with the legal position of the majority of courts of appeal that the provisions concerning the certification of facts regulated by the financial institutions in different ways, albeit more or less in the same way with regard to their substantial content, are unfair.

The Curia pointed out in its decision of principle no. G.1. of 2018 that a contractual provision according to which the financial institution is entitled to establish consumer debts on the basis of its own records and the contracting parties are bound by the certification of facts drawn up in a public document and issued on the basis of such statement, does not constitute a legally valid declaration of debt acknowledgement. Therefore, this contractual provision does not change the burden of proof to the detriment of the consumer and does not limit, either, the statutory opportunity of the consumer to lodge a claim. This contractual clause is not in violation of points i) and j) of Section 1 (1) of the Government Decree.

This legal position has been complemented with other arguments by the Curia in another published decision.[50] The Curia has also pointed out that, on the basis of point b) of Section 1 (1) of the Government Decree, the unfairness of the contractual provision could only be established if this provision entitled the financial institution to establish the appropriateness of its own performance. No such a meaning can be attached to the contractual provisions brought before the Curia. The Metropolitan Court of Appeal disagreed with the above-mentioned legal position of the Curia and initiated a preliminary ruling proceeding on this subject-matter.[51]

It is, however, worth mentioning that the case-law of the Curia[52] does not exclude the possibility of suspending the court hearing; it did not resolve to suspend the court hearing based on the above-referred facts and refused the applications to have the court hearing suspended.[53]

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49 Judgement no. Pfv.VII.22.444/2016/11; the case is in progress before the CJEU under no. C-621/17.

50 BH 2018/5/146

51 Judgement no. 13.Gf.40.337/2017/9 of the Metropolitan Court of Appeal, which is in progress before the CJEU under no. C-34/2018.

52 BH 2017/12/409

53 BH 2018/7/203

6. Relationship of the specific grounds for nullity *inter se*

If it is referred to in a litigation, the courts must first examine whether the contract was validly concluded. In case of referring to more than one grounds for nullity, the court is not bound by the order of grounds for nullity indicated in the statement of claim.

As a rule, the court should primarily examine whether the contractual provision is in violation of the law. Nevertheless, the examination of unfairness may in some exceptional cases prelude the examination of violation of the law.[54]

7. Legal consequences

The Old Civil Code has already distinguished between the invalidity and severability of a contract. On the basis of the Old Civil Code, there is also a significant difference in the legal consequences of the invalidity and severability of a contract, which depends on whether a consumer or non-consumer contract was concluded.

The Curia clearly took the position in point 2 of its PK Opinion 3/2011 that, according to the "directive-compliant" interpretation of the consumer directive, the relevant provisions of the Old Civil Code, in effect between 1 May 2004 and 1 March 2006, should be interpreted in a way that the legal consequence of the unfairness of individually not negotiated contract terms in the consumer contract, as well as the general contractual provisions is nullity, rather than voidability. Consequently, in the case of consumer contracts, unfairness can be claimed without any time limit, as opposed to consumer contracts, where unfairness is a ground for voidability.

According to the provisions of the Old Civil Code, in the case of an invalid contract, the original status could be restored or the contract could be declared valid or effective. In the application of the Old Civil Code, the judicial practice regarded, and still regards, the restoration of the original status and the declaration of a contract as valid as equivalent options among the legal consequences of invalidity. And if these primary legal consequences cannot be applied, then the judicial practice gives an opportunity to declare the contract effective until the ruling. In the case of foreign currency-denominated contracts, the PJE Decision 6/2013 unambiguously regarded the declaration of contracts as valid as a primary legal consequence, where the conditions thereof prevailed.

In the case of contracts falling within the scope of the DH2 Act, the restoration of the original status as a legal consequence cannot be applied due to a statutory legal provision. However this cannot be done in the case of loan contracts falling within the scope of the DH2 Act if we accept the legal interpretation outlined, with a minimum majority, in the summary opinion of the legal practice analysing group on the legal consequences of invalidity.

The legal consequence of severability also differs depending on whether or not the contract is a consumer contract. Pursuant to Section 239 of the Old Civil Code, in the case of a non-consumer contract, the contract as a whole fails only if the parties would not have concluded

[54] Point 3 of PJE Decision 2/2014.

it without the invalid part, unless otherwise provided by the law. In the case of a consumer contract the contract a whole fails if the contract cannot be performed without the invalid part.

Finally, we should refer that Section 239/A of the Old Civil Code allowed bringing a legal action exclusively in order to establish the invalidity of the contract, without applying the legal consequence of invalidity.[55] However, in the case of loan contracts falling within the scope of the DH2 Act, this is not possible since the entry into force of the Act.

7. 1. The need to determine the legal consequence

Under the provision of Section 239/A (1) of the Old Civil Code, consumers could use and did use the opportunity to only request the establishment of the invalidity of a contract without applying the legal consequence of invalidity, until the DH2 Act entered into force. In case of establishing invalidity or severability triggering an accounting obligation, the provision of the Old Civil Code in question could have the consequence that, in the absence of an agreement, the legal consequences of invalidity had to be clarified in another legal proceeding, so the number of legal proceedings could double.

In point 2 of its PJE Decision 5/2013, the Curia held that, in legal proceedings for a declaratory judgement under Section 239/A of the Old Civil Code, the value of the subject matter of legal proceedings should, as a rule, be established on the basis of the value of the consideration for the service specified in the contract. Consequently, if two separate legal proceedings could commence, i.e. one for establishing invalidity and another for applying the legal consequences, it would effectively result in the duplication of the procedural duty determined on the basis of the contract value. Therefore, this would have caused undesired effects in terms of the workload of the courts, court expenses and enforcing the requirement of closing legal disputes within a reasonable period of time.

Potentially, also in view of the above considerations, Section 37 (2) of the DH2 Act excluded the applicability of the provisions of Section 239/A of the Old Civil Code to contracts falling within the scope of Act.

Nevertheless, in the absence of a legal provision to the contrary, Section 239/A of the Old Civil Code and Section 6:108 (2) of the Civil Code continue to ensure the opportunity to file an action for establishing invalidity in the case of contracts with different subject-matters and non-consumer loan contracts.

At the request of the Regional Court of Budapest-Capital, the CJEU took the position in the Sziber case in relation to the above regulation that the provisions of the DH2 Act on additional procedural requirements alone do not mean that the procedural rules regulated in the DH2 Act are detrimental to the consumers. The fact that the Act intended to shorten and simplify the proceedings to be conducted before the national courts in consideration of the large number of contracts falling within the scope of the Act and the special procedural situation (i.e. accounting with the financial institutions had already taken place) was not regarded as contrary to consumer interests.

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55 This option is also provided by of Section 6:108 (2) of Act V of 2013 on the Civil Code (hereinafter referred to as “Civil Code”).

Nevertheless, the above provision of the DH2 Act raises a number of legal interpretation issues in practice. It was raised as a question if the establishment of the non-conclusion of a loan contract can be requested without applying the legal consequences. In this regard, the answer of the legal practice is that, since the scope of the DH2 Act does not cover legal proceedings concerning the conclusion of contracts, actions filed exclusively to establish the non-conclusion of a contract cannot be excluded.[56]

It is obvious that if the action is brought for establishing the invalidity of a contractual provision, which results in the severability of the contract and, based on which, the consumer has not yet been and cannot be bound by payment obligation, the filing of an action for accounting is conceptually excluded.

Furthermore, the issue was also raised whether only the establishment of the invalidity of a lien contract securing a loan contract based on Section 239/A of the Old Civil Code could be reasonably requested by referring to that the full invalidity of the loan contract also results in the invalidity of the lien contract. The judicial interpretation of the law in this regard is that if the plaintiff claims the invalidity of the loan contract as the legal basis of his action then the legal proceeding should inevitably fall within the scope of the DH2 Act. Therefore, the regulations of the DH2 Act apply to such an action.[57] In case the action was filed by the mortgagee who is other than the personal obligor, then the personal obligor should also participate in the legal proceeding.[58]

7.2. Impossibility of the restoration of the original status

A lively discussion has erupted on the fundamental issue whether there is a possibility to restore the original status in the case of loan contracts, including foreign currency-denominated loan contracts. The legal practice analysing group also addressed this issue but could not adopt a legal position which represented a sufficient majority in this issue.[59] According to a not-so-strong position, which can be regarded as the majority view with a small margin, in the case of obligations whose fundamental nature is use, such as a loan contract, the use or refraining from use cannot be undone. And the restoration of the original status is conceptually excluded due to the original irreversibility of the service provided. In such a case, the only option that can occur is accounting combined with the declaration of the contract effective until the ruling, i.e. the repayment of undue services, together with declaring the contract valid.

The legislator has also decided the above point of law. Section 37 (1) of the DH2 Act explicitly excluded the possibility to file an action for restoring the original status in the case of contracts falling within the scope of the Act. It is obvious that this provision was and is applicable anyway if no reference to the invalidity or severability of the contract on grounds of unfairness was made. But, if the unfairness of the contractual provision is the reason for invalidity, the question has arisen whether the provision of the DH2 Act in question is in line with the consumer protection provisions of EU law.

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[56] Point 2 of the memorandum of 17 March 2016.

[57] BH 2017/1/24

[58] Point 1 of the memorandum of 17 March 2016.

[59] See point 3.1 of the summary opinion.

In this regard, the CJEU gave a clear answer in its judgement delivered in the Sziber case (see points 53–55 of the judgement). According to the position of the CJEU, the national regulation precluding the restoration to the original state is, in principle, not contrary to the status where the consumer is entitled to request the repayment of amounts paid without a legal basis in an effective proceeding. It is, however, the duty of the national courts to examine whether effective legal protection without the possibility to restore the original status is ensured.

By interpreting the judgement, we must conclude that the legal provision not ensuring the possibility to restore the original status complies with the requirement set by the CJEU. Declaring the contract valid or effective is suitable for placing the consumer in a position where he would have been in absence of the unfair term.

7. 3. Declaring the contract valid

Declaring the contract valid is a court decision with ex tunc effect,the objective of which is to eliminate the reason of invalidity causing full invalidity, namely with retroactive effect to the conclusion of the contract. Declaring the contract valid means a contract amendment, which is however different from a contract amendment pursuant to Section 241 of the Old Civil Code, both in terms of its conditions or period of validity.[60]

If required in view of the characteristics of the reason for invalidity, validity may only be declared simultaneously with condemnation.

In the case of foreign currency-denominated loan contracts, the judicial practice has from the beginning regarded declaring an invalid contract valid as the most suitable legal consequence. The Curia clearly took the position in point 4 of its PJE Decision 6/2013 that, whenever possible, the courts should strive to eliminate the reason for invalidity and declare the contract valid in legal disputes concerning foreign currency-denominated loan contracts. Because declaring the contract valid creates a situation as if the parties had originally concluded a valid contract. In such a case, the court eliminates the violation of interests caused by the reason of invalidity by amending or complementing the contract. In particular, it is appropriate to provide for declaring the contract valid if the contract is invalid only due to reasons that can be considered formal.

To date, the Curia has declared a contract valid when the contract did not include the annual percentage of the interest in violation of the provisions in point c) Section 213 (1) of the Old Civil Code, . In its decisions, the Curia has pointed out that this deficiency causes the full, rather than partial, invalidity of the contract. This deficiency is, however, formal since the interest is determined in absolute terms in the contracts being the subject of the legal proceedings, so there was no obstacle to declaring the contracts valid. The Curia did not attach importance to whether consumer himself was able to calculate the interest; it deemed it sufficient that its calculability was proven.

On the other hand, the Curia did not agree with the legal position in certain judgements of the Court of Appeal of Szeged, according to which the above reason for invalidity was

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[60] See point II/2 of the memorandum on the conference held on 9–10 November 2015. The substantive and procedural conditions for declaring a contract valid were also explained in this point.

rectified by means of the interest expressed as an annual percentage in the document drafted during the accounting carried out on the basis of the DH2 Act.[61] However, co-validation is , in fact, validation, namely the case where the reason of invalidity disappears by itself (e.g. the changes in the meantime) or is removed by the parties themselves (e.g. by modifying the contract). A declaration of validity in this sense did not occur pursuant to the provision of the DH2 Act. In fact, the DH2 Act did not provide that the deficiency pursuant to point c) Section 213 (1) of the Old Civil Code is not substituted by the interest rate in the accounting.

7. 4. Declaring the contract effective

Declaring the contract effective is a court decision with *ex nunc* effect. Its aim is to eliminate the legal relationship based on an entirely invalid contract. In doing so, the mutually equivalent performances undertaken until the date of judgement are recognized by creating the legal basis for the performances.

In the context of declaring a contract effective, it is possible to settle between parties services remaining from the period before the judgement, which are partly or entirely without compensation, or the principal of the outstanding instalments scheduled for the period after the ruling by the invalid contract giving rise to a permanent legal relationship, in a way which is based on the court decision itself.[62]

Many problems and open questions arise when a contract is declared effective. However, given that the Curia did not meet with such problems in its practice and this issue was not raised in concrete cases, this study does not address these problems and questions.

7. 5. Limited invalidity of a contract

Pursuant to Section 239 (2) of the Old Civil Code, in case of partial invalidity, the consumer contract fails only if the contract cannot be performed without the invalid part.

In case of an unfair contract term, The typical legal consequence of the partial invalidity of a consumer contract is definitely that the provisions of the contract affected by invalidity are eliminated from the contract. So, these provisions should be regarded as if they were not part of the contract, while the provisions of the contract not affected by the invalidity still prevail and retain their legal value. Provided, of course, that the contract can be performed without the invalid provision.[63] This is the legal consequence also when the unfair contractual provision did not result in a payment obligation.

In other cases, however, the unfair contractual provision gives rise to a payment obligation and the consumer has already fulfilled this obligation (this has happened, for example, in the case of contractual provisions allowing the unilateral increase of interests, costs and fees, which subsequently proved to be unfair). In this case, the amount unfairly charged must be refunded to the consumer by applying the rules on unjustified enrichment *mutatis mutandis*. When settling accounts, the repayment of these unfairly charged amounts had to be ordered,

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61 Gfv.VII.30167/2017/6.

62 See point II/3 of the memorandum of 9–10 November 2015.

63 This is apparent from the case-law of the CJEU, for instance from the judgement delivered in joined cases no. C. 482/13, C-484/13. and C-487/13.

and without a temporal effect. Namely, a practice would be contrary to EU law, which cancels the payment obligation of the consumer on the basis of the unfair provision from the date of final judgement establishing the unfairness of the contractual provision is delivered.

The case where the contract cannot be performed due to the invalid contractual provision is judged in a different way. Once such case, which has since been clarified, was when the financial institutions unfairly applied a two-level foreign currency exchange rate in the contracts. In the Kásler case, the CJEU clearly took the position that the permissive provision of national law should become part of the contract in such a case. Accordingly, the DH1 Act provided for declaring the partially invalid contractual provision valid by applying the content defined in the Act.

Nevertheless, the judgement of the CJEU in question does not unambiguously clarify what is the legal consequence of a situation where a contract cannot be performed without the unfair contractual provision and there is no permissive provision in the national law that could replace the unfair contractual provision. Different legal positions exist in this regard.

The unfairness of a contractual provision is not the only reason for the partial invalidity of a contract. If the contractual provision is invalid other than due to unfairness, the legal consequence is the elimination of the specific contractual provision from the contract in this case, too. It can happen, however, that the contract cannot be performed if the invalid contractual provision is eliminated. There is no uniform legal interpretation in this regard, either. This is properly illustrated by the summary opinion of the legal practice analysing group on the legal consequences of invalidity. The Curia does not have case-law on this subject.

8. Relationship between full and partial invalidity

In the case of a claim for establishing the full invalidity of a contract, the court may establish the partial invalidity of the contract and reject the action exceeding this request if it considers that the conditions for establishing partial invalidity are fulfilled.

If the action is directed at establishing only partial invalidity, but the court notices that this is a case of the full invalidity of the contract, it must inform the parties thereof and invite them to make a statement. Nevertheless, in the absence of an appropriate claim to that effect, the full nullity of the contract cannot be established and the claim must be rejected.

9. Closing thoughts

It can be recorded as a fact that the courts had found themselves in a difficult, hitherto inexperienced situation in dealing with a very large number of legal proceedings that typically raise the same points of law, arrive within a short period of time, have a huge social impact and trigger a strong interest in the entire society. In addition, points of law have arisen in these legal proceedings in which the CJEU has a monopoly of legal interpretation. We are of the view that the courts have used all instruments guaranteed by the law in order to ensure potential legal uniformity.

The situation of the persons seeking justice and the courts was and is made more difficult by the fact that the consumers have tried and try to enforce their claims, whether justified or considered justifiable, in individual legal proceedings. Almost no action in the public interest was initiated although a focused legal proceeding would be a much more efficient solution for pursuing a claim in the vast majority of the cases.

Given this situation, a certain degree of cooperation between legislators and practitioners was required, and this was carried out in some respects. Taking account of the specific situation, the legislator deemed it necessary to exclude the applicability of certain provisions of the Old Civil Code in the cases detailed in this study, which was found compatible with the EU law by the CJEU.

Points of law have arisen in the cases presented in this study that required and still require the interpretation of the provisions of the Old Civil Code, which is in force since 1960, and has been amended several times. However, these questions have not been previously answered by the application of law, and the relevant legal literature has not done so, either. Final answers will be given if developing a legal position in the concrete legal proceedings cannot be avoided. It cannot be excluded that it will be also necessary to understand the legal position of the CJEU on certain matters.

We believe it is important to stress that we must reject the false allegation of the consumer protection organisations that the courts had taken the side of the banks. The courts have aimed and aim to expertly interpret and apply the legal regulations, including the relevant EU law, to the best of their knowledge.

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THE DEVELOPMENT OF CORPORATE AND PROJECT FOREIGN CURRENCY LOANS AND THEIR RISK IN HUNGARY

The conclusions from the experiences of corporate foreign currency lending may serve as guidelines for lending practices in the coming years. By analysing the statistics of the Hungarian banking sector, we will present the development of various segments of corporate lending and examine the correlations between foreign currency and HUF loans as well as project and non-project loans and their risk profiles. We draw the conclusion that within corporate lending, the lending in foreign currency substantially increased during the years of the crisis and has become one of the most crucial factors in every aspect of growth. At the same time, the volume of foreign currency loans was significantly influenced and its quality compromised by the fact that the portfolio mostly consisted of foreign currency project and real estate loans, the risk for which was worse as compared to the other loan segments. This fact and the slow workout process typical of the projects considerably worsened the average risk figures of the banks' loan portfolios in the long run as well.

1. Introduction

Over recent years, retail foreign currency loans, their risks, impacts, and possible measures were often mentioned in the popular press as well as in specialised literature. In the above, less attention was perhaps paid to the corporate sector and the experiences of corporate foreign currency lending.

We can also find research and analysis in the Hungarian financial literature, which examined the foreign currency risk, the foreign currency loan-taking motivations of the corporate sector, and the volume and features of foreign currency lending, especially for the period before the crisis. At the same time, the conclusion of the crisis, the aggregated banking sector figures regarding the years of the crisis, and the project financing statistics since 2011 enable us to divide the aggregated data of corporate foreign currency lending into segments and examine them in greater detail than before. It also provided the opportunity to analyse the periods before and after the crisis. We can divide the corporate loans, which were thus far handled as one unit, into not only those based on foreign currency and forints but also project and non-project loans. A substantial amount of risk data (risk provisions, NPL[1] values) is also available in these sub-segments, which further support the analysis.

By processing and analysing the stylised facts of recent years and the past decade, we can draw new conclusions and provide answers to several important questions. How did the dynamics and risk figures of foreign currency lending develop before and during the crisis, and how did they relate to corporate loans in HUF? How was it influenced by project lending, and how did it influence the development of foreign currency loans and the entire corporate lending as well as the risk indicators of the banks' loan portfolios? The answers and conclusions given to these questions would be worth linking with the results and conclusions of domestic research regarding previous corporate risk management attitudes and corporate foreign currency risk positions. The figures also indicate that the crisis came to an end and that 2017 was the start of a new era. Our conclusions and answers to these questions may serve as lessons learned for lending practices in the future in order to prevent the mistakes made by the financing parties in the past.

[1] Non-performing loan

2. Summary of the literature, earlier national research

A part of the specialised literature addressing corporate foreign currency lending deals with the macro-economic risks of lending and their impacts and regulatory questions. Most specialised literature is about the risks; however, standard financial textbooks also include how to cluster and define foreign currency risk in multiple ways (transaction risk, economic, accounting risk, etc.) and how to identify and define corporate level foreign currency risk and open position ("mismatch"). We do not address the macro-economic, regulating factor nor the foreign currency risk and conclusions of other countries in this article.[2]

The other segment of the empirical specialised literature examines the risk exposures established during foreign currency lending on a corporate level. The studies have two directions. Those belonging to the first group analyse, from public exchange rate and rate of returns figures, what kind of change the foreign currency exchange rate fluctuation causes with respect to companies' share prices and rates of returns, along with their corporate motivation and the relations of the corporate sector. This requires a time series for calculation, which is rarely available at Hungarian companies. The other direction of analysis is represented by the availability of the company databases, including company annual reports and the analysis of other publicly available company figures as well as the presentation of the results of interview surveys.[3]

The Hungarian studies typically belong to the second group: Several analyses were conducted for the periods before and during the crisis. Bodnár (2006) first presents the development of corporate foreign currency loans up until 2005 by presenting stylised facts. She presents the already clearly growing net foreign currency position; since she also publishes industry and real estate-related data, this is also useful information with respect to project financing. Afterwards, he presents the results of the interview survey taken among small- and medium-sized enterprises (SME). She examines the two main motives of indebtedness in foreign currency, the impacts of possible income in foreign currency, and the opportunities in the interest rate gap. Based on the results, the main motivation for taking foreign currency loan was the difference in interest rates. At the same time, the application and assessment of risk management within the company were examined, and it was found that a few people were aware of the impact of the exchange rate fluctuation on foreign currency loans and that the exchange rate risk is underestimated. A small proportion of companies indicated that they apply tools for risk management, typically only mentioning natural hedge solutions. The impact of various exchange rate fluctuations was also examined; therefore those companies which showed a negative result found that the depreciation of HUF would have an overall negative impact on the group of examined companies.

In her later studies, *Bodnár* (2009) continued her work of 2006 (based on a new survey and interview data) and, at the same time, she expanded the study to large companies as

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[2] A good review of topic-related specialised literature, for instance: ZETTELMEYER, 2010. and BODNÁR, 2006.

[3] A good summary of the international specialised literature of both directions has been provided by BODNÁR, 2009.

well. In addition to analysing the corporate loan structure, the question of risk management, application of hedging tools, and the understanding of corporate motivations are also important directions. Based on the conclusions, the reason for taking foreign currency loans remained the low interest rate; however, the larger the company was, the lesser the primary factor was, and natural hedge as the target came into focus. Based on the responses, companies still typically failed to pay attention to the exchange rate risk and considered risk management expensive and complicated,[4] even though better results can be observed in large companies. Then, the study examined the impact of exchange rate fluctuation on companies.

Erdész et al. (2012) and then *Erdész* et al. (2013) researched corporate foreign currency risks, the open, so-called "currency mismatch" positions in their studies, based on databases containing the corporate sector. After defining "currency mismatch" and the company rating based on it, they examined the kinds of characteristics the companies with risk had before the crisis and how they reacted to the crisis (for 2010) as compared to other companies without risks. In their analysis, they state that although 7% of companies were in an open position (rated based on an asset-resource structure and an export-import study), two-thirds of foreign currency loans belong to such companies. Relative to the benchmark group, the companies with a "mismatch" were larger and deeper in debt, which shows that they more comprehensively utilised the cheaper loan opportunity and cheaper liquidity. The performance of the companies with foreign currency loan was worse during the crisis, especially that of companies in a "mismatch" position, the creditworthiness of which deteriorated. The volume of foreign currency loans reduced, and this can be explained from both the demand and the supply side. The average duration of foreign currency loans was also reduced. After examining the companies, they confirmed that the foreign currency crisis had considerable balance-sheet impacts and corrections; therefore, the overall economic risk of companies in a risky position decreased.

In her study, *Vonnák* (2015) continued the presentation of stylised facts of corporate foreign currency loan while also including risk data and NPL rates. By analysing the corporate database in her study, she calculated hypothetical, probability of default rates by concentrating on whether these rates deteriorate in the case of companies with foreign currency loan as compared to those with HUF loan. Based on the results, she concluded that the figures for the companies with loans in CHF are riskier in every respect, and these companies appear to be in a worse situation than companies with EUR and HUF loans. The companies indebted in CHF were already riskier before the crisis, when they took out the loan. These companies were more likely to have been domestically owned companies with weaker equity position and low exports. The companies indebted in CHF experienced a greater impact because of the fluctuation of the foreign currency rate than those with EUR loans, and their risk level significantly increased at the beginning of the crisis.

By analysing company data from 2004 to 2011, *Endrész* et al. (2014) examined how the volatility, appreciation, and depreciation of foreign currencies impacted real investments and competitiveness.

[4] BERLINGER et al. address the behavioural impacts also appearing in corporate risk management, 2018.

Based on their calculations, foreign currency lending increased the investment rates and liquidity before the crisis, and it was more significant in the case of smaller companies producing for the domestic market. However, after the crisis, along with the depreciation of the forint due to the disadvantageous balance-sheet impacts, the investment of companies with foreign currency loan decreased further.

3. The development of corporate foreign currency loans and project loans until 2017 – stylised facts

It is equally typical of the above domestic studies to include the development of corporate foreign currency loans and the presentation of stylised facts, and they also base their conclusions partially on these. This represents the initial position for this research. The stylised facts can now be presented up to 2017, i.e. after the crisis, and the results of the previous studies can also be explained by integrating the project-related data.

In the next section, we will partially use the data from the above studies but primarily rely on the database regarding the credit institutions' portfolio published by the MNB[5] (Hungarian National Bank-MNB, 2018). The previous studies normally contain figures from the period prior to 2011, whereas the database of the MNB – at the time of the current study – includes the period of 2005 to 2017. The figures that provide grounds for the modern analysis and conclusions are available from 2011, since the data supply included project loans within corporate loan separately. This is important, since, thus far, the analyses did not separate corporate loans and project loans, although their risk profile and corporate balance sheet structure are significantly different.

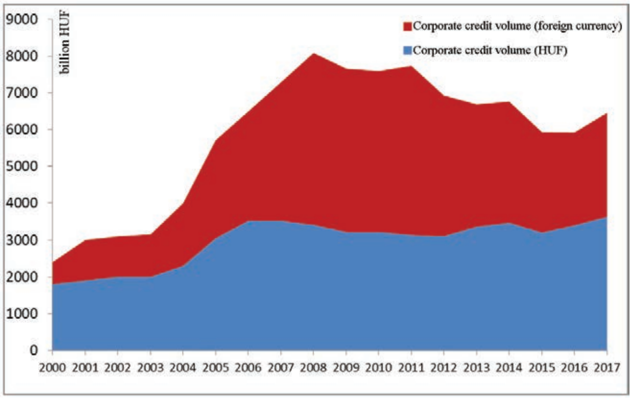
By analysing the project financing data, however, there was an opportunity to analyse purely corporate loans and the increasing volume of project loans, which was partially done in a previous study.[6] This study presented and supported the fact that the weight of project financing prominently increased in the period prior to the crisis, while, as shown in the risk statistics of the crisis, the risk was higher compared to normal corporate loans, and it largely worsened the entire corporate bank portfolio. In the following section, we will supplement this analysis by dividing the HUF and foreign currency loans and associating their results with the results of previous studies.

The volume of loans provided by the banks to companies (to non-financial institutions) continued to increase until the crisis before decreasing between 2009 and 2016. Concerning the period after the start of the crisis, 2017 was the first year when the corporate loan volume started to rise again. At the same time, it can also be observed that the real change occurred in the volume of foreign currency loans. The rate of this, especially from 2003, has continuously increased, and this sudden growth came about in just 3 to 4 years before the crisis. At that time, the proportion of foreign currency loans increased from 35–40% in 2003 to 2005 to approximately 55% in 2008. It is an important fact that the volume of corporate HUF loans from 2006 has remained broadly unchanged even in the wake of the crisis and fluctuated within a small range, between HUF 3,100 to 3,400 billion (EUR 10–11 billion). The real reduction during the crisis was caused by the setback of foreign currency loans, which caused a radical drop on an aggregated level.

[5] The figures include the data of credit institutions operating in the Hungarian banking system.

[6] WALTER, 2017.

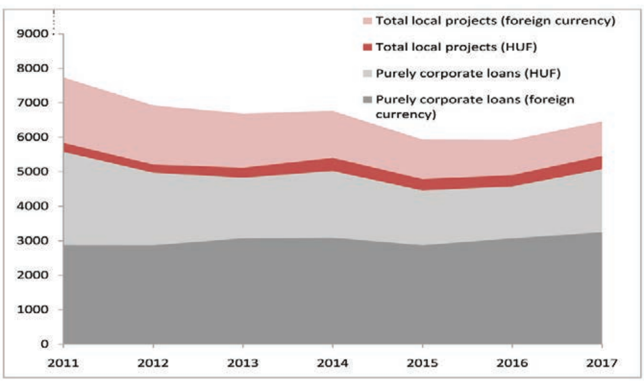
Figure 1: Corporate loan volume in HUF and in foreign currency (2000–2017)



Source: Own work, made based on the database of Bodnár (2016) and MNB (2018)

In his study, *Walter* (2017) has demonstrated how the previous, uniformly handled corporate loan volume can be divided into project loan and "pure" corporate loan not containing project loans. This is also how we will divide the corporate loan volume while also taking into consideration the 2017 figures for foreign currency and HUF loans. It can be observed that neither the volume of corporate HUF loans nor the project loans in HUF have changed, even during the crisis. By contrast, the foreign currency loan volumes continued to drop until 2016, both on a corporate and a project level. Within all corporate foreign currency loans, the proportion of project loans can be considered as significant; this fluctuated from around 40–47% between 2011 and 2016 and only dropped to 35% by 2017. It is characteristic of the risk, duration, recoverability, and flexibility features of the two loan types. While the purely foreign currency corporate loan volume basically remained the same until 2017, following two large drops in 2013 and 2014 (probably due to the more rapid balance restructuring), the foreign currency project loans fell at a slower but continuous rate, and their gross volume dropped each year by HUF 150 to 200 billion. This process only came to an end in 2017. This reinforces our experience regarding the lack of flexibility of project structures, longer loan durations, and slower collateral exercising options.

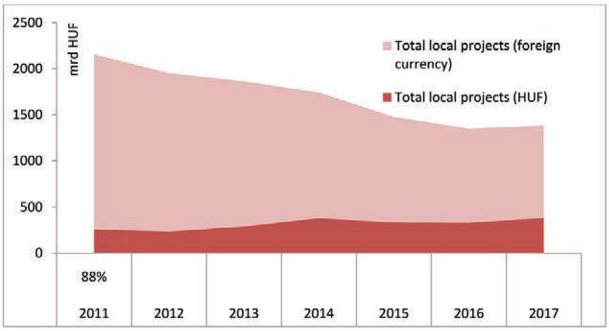
Figure 2: Corporate loan volume and project loans in HUF and in foreign currency (2000–2017)



Source: Own work, made based on the database of MNB (2018)

Examining project loans, it can be observed that the majority of the project financing took place through foreign currency loan, the proportion of which was about 88% in 2011. It is interesting that the volume of project loans denominated in HUF did not decrease even during the crisis, unlike the foreign currency project loans. At the same time, it is likely that the foreign currency project loans were converted into forints wherever possible, which played a role in the development of project loans in HUF.

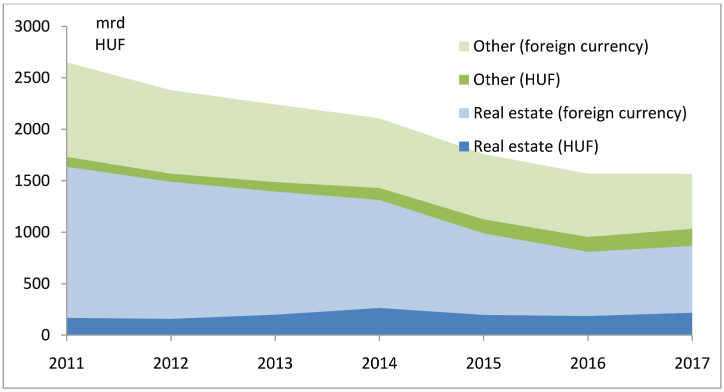
Figure 3: Project loans in HUF and foreign currency



Source: Own work, based on the database of MNB (2018)

If we compare the segments within the project loan and cross-check the housing project loans (purchase, development) with the project loans of other industries (energetics, traffic, etc.), it can be observed that over half of the project loans in 2011 were real estate project loans disbursed in foreign currency. Throughout the years, the volume of foreign currency loans of other projects also reduced, and the greatest setback was still in the real estate foreign currency loans; whereas, the volume of HUF-based real estate project loans did not change substantially. Unfortunately, we have no data pertaining to the period prior to 2011 on project financing. At the same time, earlier studies analyse the foreign currency loans by the sector, and the real estate sector, as a loan-taking party, appears as a separate category here. The real estate sector is typically built on projects and project financing; there therefore is most likely going to be a significant overlap with real estate projects, which appear later in a separate category. Based on the data provided by *Bodnár* (2009), in 2008, before the crisis, the loan of the entire real estate sector provided by foreign banks was some HUF 2,000 billion, and about 1,500 billion from that was foreign currency loan. The volume of real estate project loans in 2011 was around HUF 1,600 billion, with a volume of some HUF 1,460 billion in foreign currency project loans. The volumes of 2008 almost certainly did not grow between 2008 and 2011; therefore, we can rightly assume that the abovementioned 2008 real estate sector loan volume was essentially project loans, most likely based on foreign currency loan. If we add to this that the entire volume of the construction industry in 2008, which was HUF 500–600 billion, and half of it was foreign currency loan, we can also add that the majority of it was probably project loans. The presented figure also supports this, i.e. that the foreign currency loans were generally of a longer duration than the HUF loans, one of the motivations for which could be that the interest rate benefit can be better exploited in the long term.

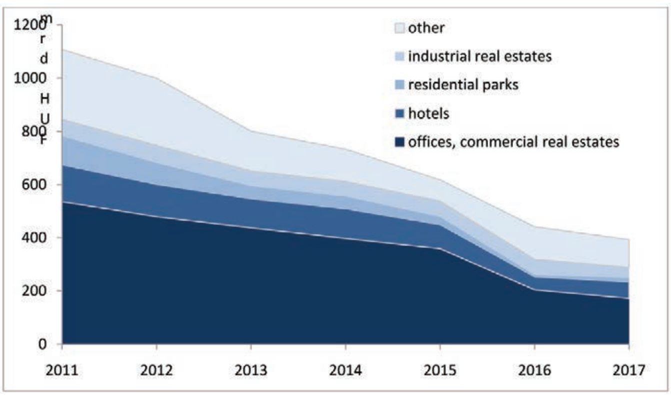
Figure 4: Real estate and other project loans (in HUF and foreign currency)



Source: Own work, based on the database of MNB (2018)

We were able to observe that the vast majority of project loans were in foreign currency loans. If we examine the real estate projects, including the largest group, real estate development, which causes the most problems, it can be established that the proportion of foreign currency loans was almost 90% at the beginning of the crisis. Their volume has continuously dropped in the last six years and has fallen to about two-thirds, and this is one of the lending segments that has not been growing in 2017 either.[7] It can also be observed that about half of the real estate development is related to office buildings and commercial properties, while the other half pertains to hotels, residential parks, and industrial real estate projects. Based on the business model and experience of the latter, real estate development is less likely to be indexed to the foreign exchange rate. Consequently, their foreign currency exposure can be considered high.

Figure 5: Real estate development and foreign currency project loans



Source: Own work, based on the database of MNB (2018)

7 Although the volume of HUF-based real estate development project loans grew to a small extent, the overall value of real estate development projects further decreased, even in 2017, despite the positive real estate market developments and conditions.

4. Risk figures in the corporate foreign currency loan portfolio

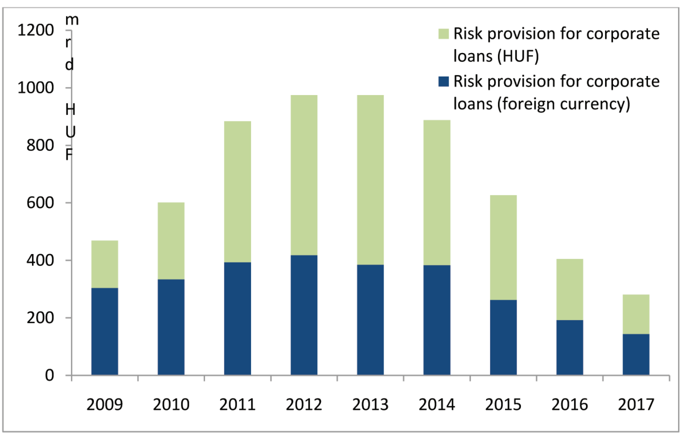
Next, we will compare the risk numbers of corporate HUF and foreign currency loans by analysing provisioning, the development of non-performing portfolios, and their correlation. Following the examination of gross loan volume, we will now present the value of risk provisions in the given segment and their percentage proportion as compared to the entire loan volume. We also have the late payment, "default" loan figures per segment.

The regulating and risk assessment rating companies (e.g. Moody's) define the default principles. These definitions might contain subjective elements as well. Generally, the 90-day late payment debt of a "material obligation" is considered as a default event or one that is likely to cause insolvency. Its exact conditions (late payment, start of legal proceedings, re-structuring) and what is considered as major debt are specified by the regulation in several points (CRR, 2013; Moody, 2013). Based on the above, we consider the over 90-day default items as non-paying or non-performing loans (NPL).

Unfortunately, we do not have timelines of equal length for the volume of risk provisions, the volume of non-performing reserves, and the volume of project loans. Statistics on the risk provisions built for corporate foreign currency loans were published from 2009; however, the same for the project loans is only available from 2011. With project loans in the case of non-paying, default portfolios, the division by foreign currency is not available. Therefore, we are unable to separate pure corporate and project loans.

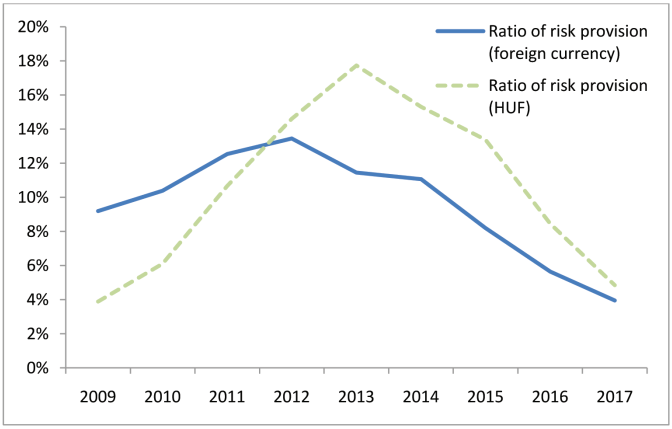
By examining the risk provisions built for corporate HUF and foreign currency loans from 2009, it can be observed that there were more risk provisions built for HUF-based loans at the beginning of the crisis than in the case of foreign currency loans, where the increasing risk (or realisation) seemed to occur later. At the same time, with HUF-based loans, the volume of the risk provisions changed little until 2015, while it sharply increased with the foreign currency loans and, by 2011, had exceeded the risk provisions volume built for HUF loans on the volume level. This increase in risk also appears in the proportions calculated compared to the entire loan volume; in a few years, the proportion of risk provisions with the foreign currency loans rose from 4–18% as compared to the 9–13% of HUF loans, which can be considered as stable (the period after 2011 presents worse statistics for HUF loans). It is also notable here that, in the case of foreign currency loans, the reporting of risks seemed to start later compared to HUF loans, where 1 to 2 years of delay can be observed.

Figure 6: Risk provisions for corporate loans (HUF and foreign currency)



Source: Own work, created based on the database of MNB (2018)

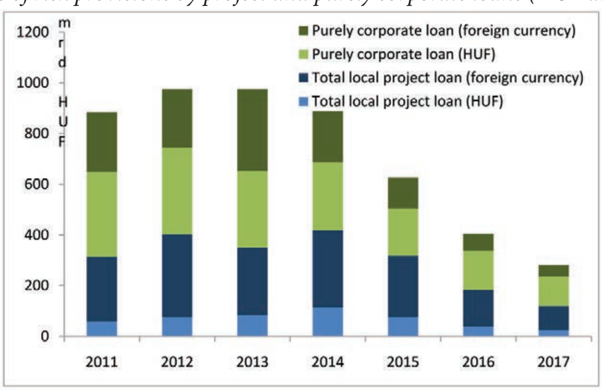
Figure 7: The proportion of risk provisions volume compared to the loan portfolio in the case of



Source: Own work, based on the database of MNB (2018)

From 2011, we can distinguish between corporate and project loans as well as the risk provisions built for these. The risk provisions volume basically did not change much between 2011 and 2014 – the risk provisions rose sharply in 2009 to 2011 – and, by this time, they were already fluctuating in the range of HUF 800–1,000 billion. An improvement can obviously be seen only after 2014, which is the consequence of several factors. On one hand, it might be due to the improvement of credit risks, the recovery of the loan after the sale of collaterals, or the selling of bad loans and the writing off the actual losses. However, it is a fact that the risk provisions volume considerably decreased between 2014 and 2017. The various risks and extended handling of project financing are indicated by the fact that it was the project loan risk provisions that started to improve most recently. If we analyse the foreign currency loans, it can be observed that over half the foreign currency risk provisions are related to projects.

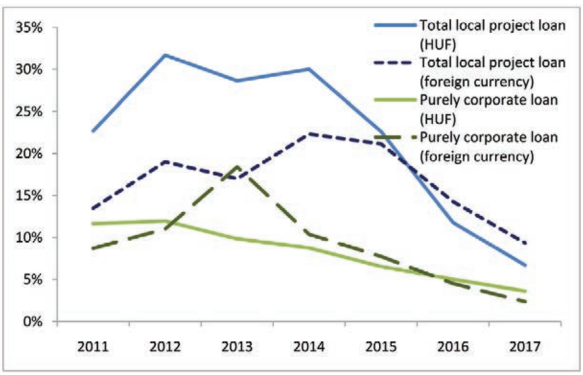
Figure 8: The volume of risk provisions by project and purely corporate loans (HUF and foreign currency)



Source: Own work, created based on the database of the MNB (2018)

We can highlight the prominent risk of foreign currency project loans if we examine the proportion of risk provisions/gross loan volume. During the years of the crisis, the statistics of domestic HUF-based project loans is the worst; however, it is less relevant for the purpose of comparison since its volume is a mere fraction of the other segments (one-eighth to one-tenth). But it still draws attention to the high project risk. The volume of purely corporate HUF and foreign currency loans and foreign currency project loans are roughly close to each other. Thus, it is more reasonable to compare these. It can be observed here that the worst image is reflected by foreign currency project loans (between 13–21%), which when compared to purely corporate loans, either foreign currency or HUF loans, exhibits a continuously higher proportion of the anticipated loss ratio. It only improved considerably by 2017 but is still worse than any other segments. The ratio of risk provisions in the other purely corporate loan segments is around 10% (except for the outstanding figures of 2014), which improved from one year to the next starting from 2014 and settled at around 5%. Figure 9 indicates that project financing might have had an extended negative impact on the banks' balance sheets. The pay-offs, workout processes, collateral sales, and restructuring progress only slowly; therefore, the improvement and cleaning of the risk provisions volume only appears one or two years later than that of the normal corporate loans. It seems that within project loans, this applies even more so to foreign currency loans.

Figure 9: The ratio of risk provisions volume to the gross loan volume by project and purely corporate loans (HUF and foreign currency)



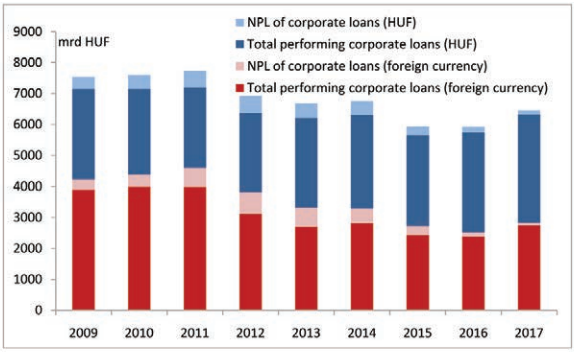
Source: Own work, based on the database of MNB (2018)

Our analysis option is most limited in relation to HUF/foreign currency loan, corporate/project loan, and the NPL. We can follow the NPL volume with a forint and foreign currency division from 2009, but we are not able to analyse it in a project/corporate respect due to the lack of data.

With respect to the development of the NPL volume and its proportion, we can draw similar conclusions with respect to what we have seen with regard to risk provision building. With foreign currency loans, the NPL portfolio was lower at the beginning of the crisis. It then increased by 2011 and exceeded the NPL portfolio of HUF loans. The NPL rate of foreign currency loans grew higher than that of HUF loans by 2012 and later reached its peak value in 2012–2013 (approx.

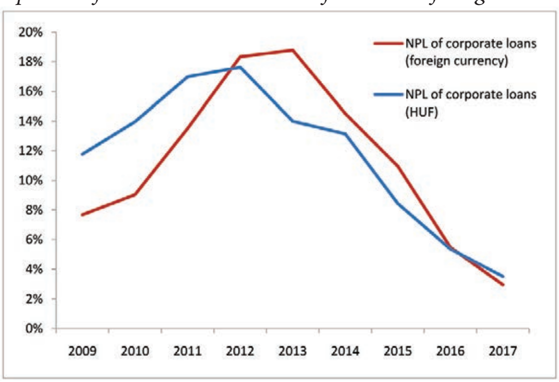
18–19%) when there was an improvement with HUF loans. Until 2016, the NPL rate of foreign currency loans was always higher than that of the HUF loans. It would be interesting to know how much of this NPL portfolio was foreign currency and HUF project loans; however, we only have indirect data on this. We know from previous studies (*Walter*, 2018) that the NPL rate of projects was considerably higher (over 20%) than the purely corporate NPL rate of the worst period (12%). We also know that 90% of the projects were foreign currency loans, with the highest majority being real estate projects. Based on this, we can safely conclude that, among bad foreign currency NPL statistics, the foreign currency project loans represent a major volume, and the real estate project loans with these have extremely bad risk values.

Figure 10: The development of performing and non-performing (NPL) portfolios in the case of HUF and foreign currency corporate loans



Source: Own work, based on the database of MNB (2018)

Figure 11: The development of NPL rates in the case of HUF and foreign currency corporate loans



Source: Own work, based on the database of MNB (2018)

Based on the above data, it can be observed that the foreign currency project loans show a higher risk profile. Of course, the question that arises when linked to previous studies is that of the open foreign currency risk possibly being the "mismatch". We only have indirect information for this, primarily from research studies carried out before 2009. In his study, *Bodnár* (2009) calculated the concerned industries' foreign currency-export ratio as compared to the overall income. Based on this, the ratio of foreign currency income, in comparison to the overall income of the industry in the real estate sector, was around 10% and was under 5% in the construction industry. Consequently, if the majority of these were project loans, we can declare that the majority of the real estate projects did not have foreign currency income, i.e. they carried an open foreign currency risk exposure.

The reason for taking out loan in foreign currency was clearly the lower interest rate, which is unambiguously seen from the questionnaire surveys as well, as a general motivation. We know from the market transaction figures that a portion of the project loan income was indexed to the foreign currency even if there was no export due to a natural hedge consideration (or simply due to market practice). Such projects can be the PPP's, where the income indexing often contains an EUR exchange rate element, or the commercial real estate developments, wherein the rental price is often decided on an EUR basis. This might improve the overall image but, at the same time, the unfavourable and worse than average risk figures illustrate that the risk of foreign currency projects was still higher than the others.

5. Conclusions and summary

The loan volume provided to companies by banks in the Hungarian market continuously increased from 2000 until the crisis, then gradually dropped to the 2005–2006 level between 2009 and 2016. When we examine it in segments, it can be observed that the actual increase and decrease took place in the foreign currency loan volume. In contrast to the general view that the banks largely held corporate lending back, neither the volume of pure corporate loans in HUF nor the volume of the project loans in HUF changed substantially even during the crisis. It might be instructive for the future that the foreign currency corporate loans started to grow again in 2017, to a greater extent than the corporate loans in HUF, but the volume of project-type foreign currency loans kept on decreasing.

The vast majority, approximately 90%, of project financing was carried out with foreign currency loan. Within all corporate foreign currency loans, the proportion of project loans can be considered substantial (40–47%). Compared to the large-scale foreign currency corporate loan volume reduction that took place in 1–2 years, the project foreign currency loans fell at a slower pace, albeit continuously during the crisis, and, moreover, kept on falling in 2017 as well. This supports our observations regarding the lack of flexibility of project structures, longer loan durations, and slower collateral exercising options as well as the caution, which was shown by the banking sector towards project loans and especially foreign currency project loans in recent years.

More than half of the project loans were project loans that were disbursed in foreign currency. The largest setback occurred in foreign currency real estate projects. However, it can be observed from the studies pertaining to the period before 2009 that the majority of real estate projects probably did not have foreign currency income, i.e. an open foreign currency risk exposure could be experienced. More than half of the foreign currency loan risk provisions can be linked to projects, which again demonstrates the higher risk level of project loans. The risk provisions rate of foreign currency project loans is also much worse than that of purely corporate foreign currency loans. The real estate-related projects compared to purely corporate loans have substantially worse risk figures and, since their weight within the foreign currency loans is quite high, they influence and worsen the values of the entire foreign currency loan portfolio. It also might be due to this that the loan volume of banks in the field of non-project type foreign currency loans increased as early as 2017, as opposed to foreign currency project loans.

By examining the risk provisions, we have observed that there were more risk provisions built for HUF-based loans at the beginning of the crisis than for foreign currency loans, where the increasing risk (or realisation) seemed to occur later. The reasons for this would be worth examining in later research. It is also justified that, in case of projects, the workout process is extended, and it is even more applicable to foreign currency project loans, which might even stay in the volume for years and have an extended negative impact on the banks' balance sheets.

To summarise, foreign currency lending and project loans had a decisive impact on the volume change of corporate loan volume and risk profile. The foreign currency project loans and real estate project loans had the largest and most extended negative impact, which took up a large proportion of the bank portfolios before the crisis. The higher risk of project lending as well as the presence of large-scale foreign currency "mismatch" led to bank portfolios that are phased out slower than purely corporate loans and have a negative impact on the loan portfolios for years.

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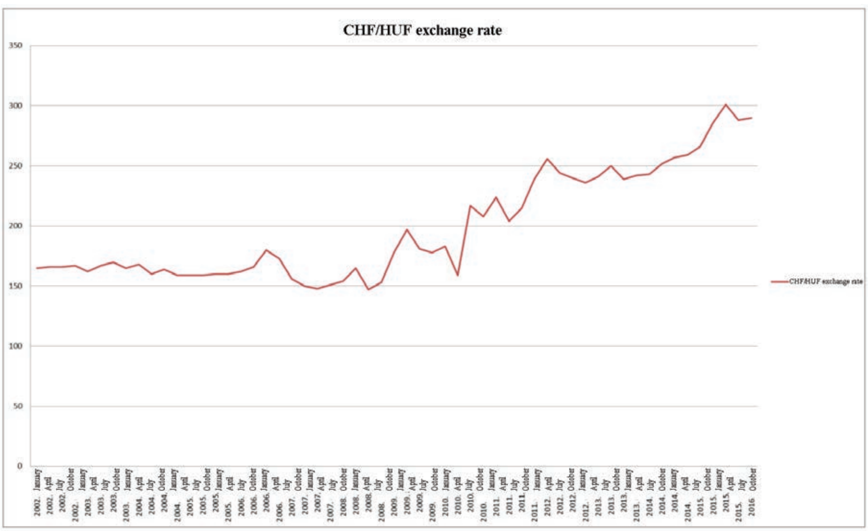
LENDING IN FOREIGN CURRENCY FROM THE REGULATOR'S ASPECT

1. Economic environment, initial status

The regulation of credit institutions is an imperative question, which is seemingly far from the members of society, however, in reality they are the beneficiaries and stakeholders on a daily basis. An increasing number of people own bank accounts, therefore they have regular contact with a credit institution, but this contact may not only appear on the resource side (placing a deposit), but also on the asset side (taking a loan). Retail lending, especially retail housing loans were one of the major, most critical and most often negotiated cornerstones of the last decade, where society and finances met.

The enabler of retail lending at the base level is the need for housing and other consumer goods. When taking a loan, the key decision basis of the population is the interest rate, for which the Annual Percentage Rate of Charge (APR) provides a guideline. However, in certain periods, the APR may not be considered as comprehensive support, since other understanding from the client is also required. The APR may not answer the lapsing of time, i.e. the changes in the interest rate and exchange rate environment, currently the key hazard, namely, the increasing of the interest and exchange rate level. Regarding retail lending, the financial knowledge and awareness of the client, as well as the adequate alignment of consumer protection are always key questions. Hence why several regulatory elements were established, by which information and understanding appear as expectations. At the same time, it is important to highlight that for years there was an interest rate and exchange rate environment, which caused the population to believe that, in fact, there was no exchange rate risk mentioned in the information provided to them, since the exchange rate was fluctuating in the range of 10%, between HUF 150–165 for years (the years of 2002 to 2008 was the period of great increase in lending in foreign currency). Substantive deviation from this range was not typical, and even if it happened, the exchange rate of the Swiss franc returned to the bottom of the above mentioned range within a short time.

Figure: CHF/HUF exchange rate 2002-2015



Moreover, in the beginning of the 2000s, the interest rate environment was one where the interest rate for HUF-based loans was explicitly high. Consequently, the population's demand for such loans was also limited. Since the credit institutions are interested in satisfying demand, they also started product development in this direction. This was facilitated by the fact that there are typically affiliated banks in the Hungarian bank system, with mostly European parent companies. These affiliated banks were able to secure resources in foreign currency from the parent banks. Moreover, due to the new product, a product with a beneficiary interest rate was created for clients. By opening new markets, it is also true that the national affiliated banks could utilise the resource from the parent bank advantageously, which in addition to the affiliates was also enticing for the parent banks. Consequently, these resources were available for the national affiliated banks in the long-term and in a larger amount. Since lending in HUF was almost unreachable for companies and the population due to the high local interest rate environment, the credit institutions increasingly turned towards lending in foreign currency.

The above processes resulted in the mass propagation of foreign exchange credits among the population, where record keeping and settlement for the clients was typically in Swiss francs.

Choosing a foreign exchange credit seemed obvious to the clients, since it was clearly more beneficial in interest return, and as you can see in the above figure, when lending ramped up and the amount of retail foreign exchange credits increased between 2002 and 2008, there was no substantive fluctuation in foreign currency. Therefore, the awareness-raising regarding the exchange rate risk was not paired with a sense of experience, which might have oppressed the reality of the impact in the borrowers of loans. Hence, that is why the government responsible for regulating the financial sector and the surveillance authority in charge of the stability of the financial sector have decisive roles in possibly proactively, but at least retroactively supporting and protecting the borrowers of loans. Accordingly, the Hungarian Financial Supervisory Authority and the Hungarian National Bank made numerous awareness-raising announcements, analysis and background studies during this period to warn clients to be more cautious concerning the risks of indebtedness in loans taken in foreign currency.

The regulator also took several steps in regards to legislation. Regarding these measures, starting from more accentuated awareness-raising to the risks, presenting the offset of exchange rate impacts and by keeping the saving of homes in sight, the most powerful intervention tools also appeared on behalf of the regulator.

Some of the steps outlined below target the entire scope of the concerned, and some of only those in the tightest situation. However, you can see with all steps that the cooperation of the concerned, i.e. the loan borrowers, is also required to enable the tool to efficiently fulfil its role and become successful. Accordingly, following the stipulation of the measures, the scope of the concerned, i.e. the loan borrowers, should also be indicated.

2. Regulatory steps regarding lending in foreign currency – proactive measures

2. 1. General rules of information – risk exposure declaration

During the spreading of retail lending in foreign currency – by recognising the risks and the related, strongest awareness-raising requirement – the first regulatory step, the introduction of the so-called risk exposure declaration was taken. The regulatory aim was for clients to receive better, more thorough and clearer information prior to taking the loan. The modification of Act CXII of 1996 on credit institutions and financial enterprises (hereinafter referred to as: old Credit Act) passed in September 2004, disposed of mandatory information that should be provided in case of contracts in foreign currency.

According to the provisions that came into effect on 1 January 2005, in case of contracts in foreign currency signed with retail clients, aimed at lending in foreign currency, the financial institution should disclose the risk impacting the client in their contractual deals, with a signature the client verifies acknowledgement. Based on the regulation, the risk exposure declaration had to contain information on the exchange rate risk, as well as its impact on the instalments.

This Act is still in effect and must be applied in an almost unchanged form. The rule according to the above is contained in Act CCXXXVII of 2013 from 1 January 2014 on credit institutions and financial enterprises (hereinafter referred to as: Credit Act) 271. Sections § (4)–(5), and Act CLXII of 2009 from 1 February 2015 on consumer loans (hereinafter referred to as: Consumer credit act) 21/A. sections § (1)–(2).

2. 2. Direct informational obligation rule – Annual Percentage Rate of Charge

The modification of Government Decree No. 41/1997 (5. III.) on deposit interest, the yield of securities and the calculation and announcement of the annual percentage rate of charge (APR) targeted the proper demonstration of the costs of foreign exchange credits, which was also passed at the end of 2004. The modification specified the rules of defining the annual percentage rate of charge (APR) concerning retail loans, including foreign exchange credits. Although the relevant principle of the European Union did not require it, the old Credit Act disposed of the application of the APR also for new housing loans as a new regulation.

According to the Government Decree, the APR had to be specified based on payments and instalments established in HUF as a main rule, which reflected the exchange rate differences applied upon disbursement and redemption (buying and selling rates). Further, the expenses arising in foreign currency also had to be taken into account during the establishment of the APR. The decree also unambiguously stipulated that in case of foreign exchange credits and loans based on foreign currency with the indication of APR, the clients' attention shall be firmly drawn to the fact, that the value of the APR does not reflect the possible exchange rate risk regarding the loan.

The modification of the Government Decree stipulated that if the advertisement includes the interest rate, or any expenses or instalments of the loan, the APR shall also be indicated. During its indication it shall also be considered, that awareness-raising should be of at least equal size and appearance regarding the relation of the APR and the instalment and/or interest rate. This rule aimed at preventing those ads, which lured clients with an item taken out of context, e.g. the low interest rate of foreign exchange credits or of loans based on foreign currency. These rules also had to be applied from 1 January 2005.

The introduction of regulations and the risk exposure declaration regarding the APR and advertisement, which put all concerned into a more responsible and stricter consideration required in the decision-making position, however, did not limit the further ramp up of foreign exchange credits until the considerable weakening of the HUF against the EUR and especially the Swiss franc at the end of 2008.

2. 3. Self-regulation attempts

In conjunction with the spreading of lending in foreign currency we should also not avoid stating that in the first half of the 2000s, in accordance with international tendencies, the explicit enhancement and increasing of competition was in the foreground in contrast with (legal) regulation. The proposals of the Expert Committee Examining the Retail Banking Services, established in 2006[1], also focused on increasing competition and lending by stating that when regulation is required, self-regulation should be considered as primary against governmental regulation, and only in case of its insufficiency should the regulator's intervention take place.

In order to enhance competition, the Expert Committee Examining the Retail Banking Services wished to facilitate the switching of banks and replacing loans by the clients, and assigned a priority role to increasing transparency (to providing information and the transparency of unilateral contract modifications), as well as the strengthening of conscious consumer behaviour. Following a longer preparation period, in order to realise these expectations by self-regulation, the Hungarian Banking Association approved several proposals and codex in 2008 regarding unilateral contract modification and loan replacement, and the banks' Code of Conduct aimed at specifying the general norms of responsible lending came into effect on 1 January 2010. Besides self-regulation and regarding the regulating responsibility, we should also highlight that the regulating side, as well as the supervisory authority, were also present in the preparations of the Code of Conduct. Concerning the supervisory responsibility – although we are talking about self-regulation –, the compliance with self-regulating elements also appeared as part of official control. In certain cases, the bank was risking a severe penalty if it did not comply with the commitments of its self-regulation.

Regarding its contents, the mandatory information providing responsibility on the Code of Conduct also appeared in the Credit Institution Act, which shows the shifting of self-regulation towards control in the framework of responsible regulator's behaviour. In parallel to the above, legal regulating pursuits also intensified. As part of this, the modification of the Credit Institution Act by Act CL of 2009 stipulated that in case of consumer loan agreements the lender is only eligible to exercise its right of unilateral modification if the agreement

[1] Government Decree No. 1097/2006 (5. X.) provides for the establishment of the committee.

contains the itemised definition of objective conditions calling for the modification, and the lender specified its pricing principles in writing. At the same time, these pricing principles were generally not public, i.e. controllable by the client, since only the supervisory board was entitled to check whether they comply with the legal provisions.

3. Regulatory steps regarding lending in foreign currency – reactive measures

3. 1. Agreement of 6 November 2008

The volatility of exchange rates was not significant until the fall of 2008. Therefore, awareness-raising and highlighting of risks did not dissuade clients, and the taking of housing foreign exchange credits dynamically increased until the autumn of 2008. The turn took place when with the sudden change of the exchange rate, the instalments considerably increased overnight. This is when the regulator party took another step.

In order to mitigate the impact of the exchange rate fluctuation, on 6 November 2008 the Minister of Finance and nine commercial banks signed an agreement on tools supporting the redemption of debtors with foreign exchange credits. According to the agreement, banks allowed for the extension of the duration of the loan based on the debtor's request without charging an extra fee, temporarily reduced the amount of instalments for debtors, who were forced into a difficult situation, enabled the switching of foreign exchange credits into loans in HUF, and also handled early repayments flexibly. The commercial banks with the largest amount of foreign exchange credits and the mortgage credit institutions signed the agreement. Based on the original agreement, the foreign exchange credits could be converted into HUF free of charge until 31 December 2008. The exchange rate in this period was around HUF/CHF 170–180. Since the regulating tool again required the cooperation of clients, the success of the measure was ensured by the understanding of concerned clients, i.e. their understanding and judicious perception was necessary regarding new awareness-raising of the risk. Unfortunately, however, very few people used the opportunities contained in the agreement, and it impacted approximately 6,000 contracts. Out of these, the transformation of loans to those that were HUF-based were under 1,000, while the exchange rate of the Swiss franc was still near the borrowing rate, especially compared to subsequent periods.

The Hungarian Banking Association informed the Ministry of Finance on 16 February 2009 that it had initiated the extended application of the agreement with the banks, who participated in the initial agreement, which was accepted by these banks. Moreover, the scope of engaged institutions in the program was extended by another two banks.

The extended application and the extended scope of applying banks ultimately resulted in the cooperation of a higher number of clients. Thanks to this, by the end of 2009 the number of rescheduled contracts exceeded 61,000.

With those constructions however, where the credit institutions only provided a temporary ease, following the grace period the debt burden again rose significantly, and could even exceed the level prior to rescheduling, i.e. the transformation to a HUF loan would have seemingly been the most favourable offer worth taking.

3. 2. Responsible lending – regulation reinforcement

In the beginning of the 2000s, competition between the credit institutions and the considerable demand for housing loans on behalf of clients resulted in the loosening of lending conditions and the spreading of increasingly risky products. The size of disbursed mortgage loans continuously increased compared to the value of the collateral. The proportion of the loan compared to the collateral (LTV) was 50% to 60% on average, but between 2006 and 2008 the higher LTV level increased, and the proportion of loans at even 100% also became visible. Through the permanent depreciation of HUF and the shifting of financing costs of the banks into loan interest, the instalment growth of households having foreign exchange credits increased the proportion of default loans. These processes called for limiting lending to prevent the over-indebtedness of retail clients.

In December 2009, the Act CLXII of 2009 on consumer lending was approved (Consumer Lending Act), the primary aim of which was to transfer the provisions of the Directive 2008/48/EC on consumer loan agreements into Hungarian law. The majority of the provisions of the Act came into effect on 11 June 2010, in accordance with the transfer deadline provided by the directive. Also due to the above mentioned process – in the framework of the necessary measure, extending over the regulatory scope of the directive in order to strengthen consumer trust –, a significant part of the regulatory measures was extended to mortgage loans and financial lease contracts as well.

The Consumer Loan Act specified the rating of consumers' creditworthiness as the responsibility of the lender, which was not only required prior to signing the loan agreement, but also in case the loan amount was increased. The information required for the creditworthiness rating might be based on the information provided by the consumer and the utilisation of the loan reference service. The Act provided authorisation for the detailed creditworthiness rating on a government decree level.

At the end of December 2009, based on this authorisation, the Government accepted Government Decree No. 361/2009 (30. XII) on the conditions of astute retail lending and creditworthiness rating. The aim of this provision was to promote responsible lending, to mitigate the risks of foreign exchange credits and to prevent the over-indebtedness of retail clients. According to the Government Decree, when offering a loan the client's creditworthiness and creditable status shall be examined in all cases, i.e. the institutions do not provide loans by exclusively considering the collateral. In its internal policy the lending party had to indicate the means of establishing the creditable limit (the amount representing the maximum monthly loan instalment paying ability) for each loan type, as well as the income items and information, which can be considered for the calculation. In case of foreign exchange credits, and based on foreign currency, the creditable limit had to be defined lower than for the HUF limit. In case of Euro-based loans or loans in EUR, the creditable limit could be maximum 80% of the limit defined in HUF, and maximum 60% of the limit of other currencies. According to the new regulations, during the establishment of the creditable limit, the lending party had to take into account the client's all known loan debt.

The Government Decree specified the maximum proportion of the loan compared to the collateral in case of loans secured by mortgage based on a property, loans provided for vehicle purchase and financial leasing. Different limits were established for HUF-based loans, EUR-based loans and loans in other foreign currency, considering he different risks related to the products.

It was a considerable regulating novelty, that it was the first time the Government Decree differentiated between loans in HUF and foreign exchange credits concerning creditworthiness. Once these limiting regulations of the Government Decree came into effect, the newly disbursed foreign exchange credits basically disappeared.

3. 3. Regulating the credit intermediaries

The exposure of severe stability risks in lending in foreign currency also highlighted the fact that the strict regulation of credit intermediaries must not be delayed any longer. Based on the previous regulations, practically anyone could mediate credit without special conditions by the intermediaries' specific interest in, for example re-signing or replacing loans due to their remuneration.

The new regulation regarding credit intermediaries – which was filed by Act CL of 2009 into the Credit Institution Act –, introduced double clustering concerning mediating financial services. On one hand, it defined the types of financial service mediation as an activity (therefore introduced brokerage activity). On the other hand, it isolated the dependent and independent intermediaries by making the type of activity performed by the intermediary as primary isolation criteria, and also, if it mediates more services, whether these services compete with each other or not.

In addition to the above, the old Credit Act limited the possibility of the establishment of intermediary chains for the sake of transparency and clear responsibility relations. At the same time, it forced the intermediaries to inform their clients (including their future clients) about on whose behalf they are acting and mediating.

As an additional important point, the regulation with a new aspect also included the remuneration of intermediaries, specifically stipulating if regarding this activity the intermediary is only entitled for remuneration by his client, i.e. the party on whose behalf he is acting.

3. 4. Forced sale quota system

Numerous regulating steps were taken, numerous positive shifting occurred, and clients were cooperating in an increasing number for a solution. Regarding the mitigation applied from the end of 2008, for instance, the number of participants grew by 61,000, however it was still insignificant compared to the millions of contracts. Therefore, due to the increasing crisis, another step was needed by the regulator.

Following the expiration of eviction and auction moratoria introduced for temporary crisis management on 11 August 2010, the Parliament passed the provision on forced sale quota, i.e. Act LXXV of 2011 on fixing the exchange rate for the instalments of foreign exchange credits and the forced sale of residential properties. The aim of this was to prevent an unjustified large proportion of properties emerging at the same time on the market during the forced sale of properties serving as collateral for housing loans. The forced sale quotas limited the number of properties that could be given for forced sale on a quarterly basis by the creditors, which in turn also limited the number of cases possibly resulting in eviction by 2014. The aim of the legal regulation was to prevent mass eviction and to protect the housing market.

The banks however avoided the auctions regardless of the quota. This is also supported by the fact that the number of properties actually nominated for forced sale was considerably lower than the amount ensured by the quota, i.e. the credit institutions were also not interested in forced sale. In addition to the regulations regarding risk management and collateral sales, the low price of the properties also contributed to the banks not fully utilising the opportunities provided by the quota.

3. 5. Exchange rate cap

The loan redemption at a discounted exchange rate was introduced by Act LXXV of 2011, also regulating the quota system on the fixing of the instalment exchange rate of foreign exchange credits, and the forced sale of residential properties. Based on the Act that came into effect in August 2011, clients who signed a frame agreement for an omnibus account credit could pay their redemption for three years at a discounted fixed rate, and the difference between the redemption calculated based on the actual and fixed rate was credited to a sub-account, the omnibus account. Therefore, the obligation did not cease, but it meant a temporary reduction of the burden. This accumulated amount would have to be re-paid after the period of fixed exchange rate. After three years however, the accrued amount would have significantly increased the credit instalments, therefore this construction was modified from 1 April 2012, making it more beneficial for the population.

Based on the agreement signed with the Hungarian Banking Association on 15 December 2011, Act XVI of 2012 modifying the exchange rate cap construction increased the application period of the fixed exchange rate from three years to five, and also provided considerable debt remission. For loans in Swiss francs, instead of the actual exchange rate one had to pay redemption at HUF/CHF 180 for five years, but at the latest by 30 June 2017. For EUR loans the fixed rate was HUF/EUR 250, for the Japanese yen HUF/JPY 2.5. The precondition for utilising the fixed exchange rate was that the payment delay of debtors could not exceed 90 days and the amount of the loan upon receiving it could not exceed HUF 20 million. The clients who chose the exchange rate cap only had to pay the deferred capital debt from the omnibus account credit, and the interest part of the omnibus account credit was taken in 50–50% by the banks and the budget.

The law amendment approved in 2013 eliminated the previously, several times modified entry deadline and the closing date of 30 June 2017 for exchange rate fixing, therefore the only remaining limitation was the period regarding the 60-month suspension. The Parliament also decided on 5 November 2013, to enable people to apply for exchange rate fixing upon approval who have debts over 90 days, or took a loan of more than HUF 20 million in foreign currency. This basically enabled all clients to exercise the opportunity and in certain cases the non-performing loans could also return to performing loans.

According to the regulation, the interest rate of the amount accrued on the omnibus account was three months BUBOR during the application of the fixed exchange rate, and afterwards it had to equal the market interest rate defined for HUF loans provided for the same purpose as the foreign exchange credits provided by the financial institution.

The regulation on exchange rate fixing was supplemented by Government Decree No. 163/2011. (22. VIII) on the disproportionately high monthly redemption for loan frame agreement regarding omnibus account credit. Accordingly, once the fixed exchange rate application period was over, the monthly instalment rate of the omnibus account must not have exceeded 15% of the last instalment during the fixed exchange rate application period, at the same time the redemption of foreign exchange credits took place at the prevailing exchange rate. The duration of the omnibus account contract could exceed the original duration of foreign exchange credits by a maximum 30 years, however, it could not exceed 75 years of age of the debtor. With this, the regulator meant to inform the client about the impact of the already significantly increased exchange rate, therefore keeping the burdens due to the instalments at an acceptable level.

The full scope of potential users was some 450,000. The number of entrants exceeded 170,000. During the bank settlement of 2015, in case of clients with an exchange rate cap contract the financial institutions had to first credit the overpayment for the debt on the omnibus account, which strengthened the offset of future burdens. As a result of this, the majority of exchange rate cap contracts were terminated during the bank settlement. Out of the more than 170,000 contracts signed before 2015, less than 15,000 contracts remained and even with those a considerable reduction of remaining liabilities appeared.

Based on the Act on conversion into HUF that came into effect on 1 February 2015, the loans with an exchange rate cap were also converted into HUF. In the case of these contracts it had to be ensured that the instalment did not change until the original closing date of the exchange rate cap (for 60 months from its signing), and only increase by maximum 15% afterwards. However, in most cases the duration of the loan had to be extended for this. The burdens of debtors were further reduced by the fact that, in the period since the conversion into HUF, based on the general interest rate reduction and the provisions of the Fair Banking Act the interest rates of existing mortgage loans could be moderated, consequently the amount of instalments as well.

3. 6. Repayment of outstanding debts (early repayment)

The option to repay the outstanding debt in one lump sum at a discount rate was facilitated by Act CXXI of 2011 on the modification of certain laws related to home protection, which came into force on 29 September 2011. During the repayment of outstanding debts, the foreign exchange credits could be repaid at a discounted rate; in case of a loan in Swiss francs at HUF/CHF 180, in the case of EUR at HUF/EUR 250, in the case of Japanese yen at HUF/JPY 2. Anyone could announce their wish to repay outstanding debts by 30 December 2011. The availability of the amount of early repayment had to be certified by 30 January 2012, and the loan had to be repaid by the latest on 28 February 2012. The primary target of early repayment was to reduce the amount of foreign exchange credits causing notable vulnerability in the country.

Nearly 170,000 debtors exercised the option of early repayment, and a total of HUF 1,355 billion in foreign exchange credits was repaid. The discount resulted in HUF 370 billion savings for debtors. Thanks to the lower exchange rate, a debtor received an average of HUF 2,176,000 discount. During the early repayment, HUF 313 billion loan was taken by the population, 25% of this was disbursed by cooperative banks. Early repayments in many cases took place in HUF loans. One third of early repayments was paid by replacement HUF loans.

Regarding the foreign exchange credits from the aspect of breakdown by foreign currency, the largest volume was the early repayment of Swiss franc loans. A total of 25.3% of these were paid in the entire financial sector. 92% of all early repayments resulted from the early bank repayment of CHF loans. 23.3% of Japanese yen loans were repaid. However, the volume here is considerably lower than in case of Swiss franc loans. The majority of EUR-based loans were disbursed after 2008, above the HUF/EUR 250 exchange rate, so the majority of debtors were not eligible for early repayment. Accordingly, only 2.1% of loans were repaid under the program. The average amount of repaid loans was HUF 5.8 million at the fixed early repayment exchange rate.

On 30 September 2011, there were 750,000 mortgage foreign exchange credit debtors, whereas on 31 March 2012, there were only about 560,000. The volume of foreign exchange mortgages decreased from HUF 5,600 billion on 30 September 2011 to HUF 4,245 billion.

3. 7. Discounted conversion of default foreign exchange credits

In the agreement signed by the Government with the Hungarian Banking Association on 15 December 2011, the members of the Hungarian Banking Association committed to convert the debt of foreign exchange mortgage debtors with over 90 days of default payment, reaching the amount of the minimum wage on 30 September 2011 into Forints. Furthermore, the banking sector also committed to simultaneously dismissing 25% of the debt, whereby supporting the situation of foreign exchange credit debtors, and by possibly making the credit redeemable again for the debtor. In the case of default obligations already cancelled outside the mandatory scope, certain banks enabled the conversion option on a voluntary basis, for which discounted conversion individuals could apply by 15 May 2012. In the case of compliance with the conditions stipulated by law, the financial institutions were obligated to convert all outstanding debts based on existing contracts by 31 August 2012.

In the case of over 3,000 debtors, HUF 6.3 billion debt was released under the mandatory program. The rate of voluntary conversion (in the case of already terminated contracts) somewhat exceeded the volume of mandatorily converted contracts based on the estimates.

3. 8. National Asset Management

The National Asset Management Program aimed at helping the most socially deprived credit debtors, regardless of whether they took a foreign exchange or HUF loan. Nemzeti Eszközkezelő Zrt. (National Asset Management) purchased the real estate of the credit debtor at a discounted price, but the debtor could stay in the accommodation by paying a fair rental fee as a tenant, while the creditor dismissed the remaining amount of the mortgage credit.

Act CLXX of 2011 on the housing of natural persons not able to fulfil their obligations derived from the credit agreements and regulating the operations of Nemzeti Eszközkezelő

Zrt. was passed by the Parliament on 31 December 2011. Only those persons were entitled to utilise the National Asset Management based on the regulation approved in December 2011, who receive an active-age provision and have at least two children.

The Government entered an agreement with the Banking Association on 15 December 2011, to initiate the modification of the Act in order to make the National Asset Management purchase the residential property of mortgage credit debtors even if they only raise one child in the household. Moreover, the Government committed to increase the number of apartments to be purchased from the previously planned five thousand to twenty-five thousand.

Helping those in need was a priority question, but at the same time the aspects of social fairness and the budget also had to be considered. Therefore, the establishment of the social criteria system became necessary by the regulator. The social conditions regarding the National Asset Management were specified by Government Decree No. 128/2012 on certain rules in connection with the operations of Nemzeti Eszközkezelő Zrt. (26. VI).

Based on this Decree, instead of the previous two children, which made people eligible for the family subsidy, now only one child was enough to be eligible for the program. The decree included people receiving housing maintenance support and also nursing fee into the scope of eligible persons. Thanks to the changes in legislation, the program has gained momentum since September 2012.

At the same time of signing the sales contract, the Nemzeti Eszközkezelő Zrt. signed an unlimited rental contract with the previous credit debtor. The amount of the rental fee is regulated by Government Decree No. 128/2012. (26. VI), which must not be deviated from. According to the Decree, the basis of the payable rent is 1.5% of the residential property's market value established upon taking the credit. This amount is paid by the tenant by dividing it into 12 months, in equal monthly amounts. By taking an example of a property with a market value of HUF 15 million, the rent is HUF 18,750 per month. In case of property with a market value of HUF 10 million, the monthly rent is only HUF 12,500. The rent can be increased at a rate equal to the previous year's consumer price index.

In excess of the purchase price paid by Nemzeti Eszközkezelő Zrt., the credit debtor had no remaining debt towards the financial institutions, and the remaining part of the debt was dismissed. Therefore, the debtor could get rid of the debt under organised circumstances and housing also remained secured. The Act also disposes of the right of re-purchasing: the ex-debtor may re-purchase the apartment, if his/her financial situation changes favourably.

From 1 January 2013, with the modification of the Government Decree of December 2012 on the above mentioned socially deprived-based conditions, pension beneficiaries with own entitlement, as well as participants in the public works scheme could also join, if they satisfied the conditions regarding the credit agreement and the property. The legal environment and the prescribed system of conditions were modified several times depending on the status of utilisation, to ensure that the program provides support for as many deprived families as possible based on the opportunities.

The program, which was previously planned for three years by purchasing 25,000 apartments until the end of 2014, was extended. In the framework of the extended program, 36,000 properties were involved until the end of 2018.

4. Regulatory steps regarding lending in foreign currency – closing measures

In the case of all previous measures, the necessity for cooperation appeared, i.e. the debtor's understanding was also needed to make the measure successful. The number of participants in the program was considerable until the end of 2014, however it was still not full-scope. Hence, the final solution in this respect was also represented by settlement and the conversion into Forints.

The matrix supports the existence of the notable scope of concerned people, and the scale of the problem by presenting figures from the autumn of 2014.

Matrix: The volume and number of residential loans (September 2014)

	Foreign exchange credits		HUF credits	
	Volume (million HUF)	Number of contacts (pcs)	Volume (million HUF)	Number of contacts (pcs)
Housing loan	1,743,362	206,361	1,505,219	501,612
Home equity loan	1,583,004	256,204	440,112	158,026
Vehicle loan	154,731	112,841	82,582	93,961
Personal loan	28,882	68,307	263,595	614,309
Total	**3,509,979**	**643,713**	**2,291,508**	**1,367,908**
Remark: the banking system and branches.				

Source: Hungarian National Bank

4. 1. The derecognition of foreign exchange credits and bank settlement in 2015

The decision of the Curia of June 2014 provided legal opportunity for the comprehensive settlement of the problem. Based on the legal unit decision of the Curia (2/2014 Civil Law Decision), the exchange rate risk encumbers the debtor as a main rule. The unfairness of this provision can only be examined and established, if the contents of the contract for the generally informed, reasonably attentive and prudent average consumer (hereinafter referred to as consumer) upon signing the contract – considering the text of the contract and the information received from the financial institution – was not clear and understandable. If due to the insufficient information from the financial institution or the lack of information, the consumer could justifiably think that the exchange rate risk is unreal, or only concerns him/her to a limited degree, the provision of the contract regarding the exchange rate risk is unfair, consequently the contract is partially or completely invalid. Due to their nature, these questions cannot be clarified by the legislator, but through judicial channels.

At the same time, the Curia rated the different exchange rates applied upon disbursement and redemption as unfair, the same as the contractual provisions facilitating unilateral contract modification, if they did not meet certain basic principles (e.g.: clear wording, objectivity, transparency). The Act based on the Curia's decision, passed in July 2014[2], stipulated the nullity of the contractual obligation specifying the application of the exchange rate gap and established presumption for the unfairness of unilateral contract modification-related terms. The courts could make a decision about presumption in civil proceedings.

During 2015, the banks had to settle with their clients, who took foreign exchange credits, about repaying the overpayment due to unfair exchange rate gap and unilateral contract modification. This resulted in a considerable reduction of burden for households, which also appeared in the decreased instalment amount. The debtors' remaining capital debt decreased and also the monthly instalment obligation by an average of 25%. The instalment obligation of clients was further reduced by the fact that, with all credit agreements impacted by the settlement, fair interest rates had to be reinstated from 1 February 2015, which typically equalled the interest rate that was applied upon signing the contract.

Further support was provided by the conversion into Forints. The act on the regulation of conversion into Forints, which came into effect on 1 February 2015[3], guaranteed the conversion into Forints of housing and home equity mortgage credits. The credit of nearly half a million debtors was converted by the banks. In accordance with the decision of the Curia, the conversion took place at the market exchange rate. To avoid speculation, the applicable exchange rates during conversion were fixed on 7 November 2014: HUF/CHF 256.47 (the average of the period since the Curia decision of 16 June), HUF/EUR 309.97 and HUF/JPY 2.163 (the official MNB exchange rate as of 7 November). The conversion into Forints protected the population from significant additional burden, since the conversion was on a fixed exchange rate in November 2014, while from the beginning of 2015, the HUF/CHF exchange rate considerably increased. The settlement and the conversion into Forints occurred simultaneously.

The appreciation of the Swiss franc in January 2015 also notably increased the burdens of debtors having foreign exchange vehicle credit. Following the conversion of foreign exchange mortgage credits into Forint, the Government looked for a solution for the conversion of consumer loans into Forint as well. The Parliament passed the act regulating the conversion of foreign exchange vehicle and consumer credits on 22 September 2015[4], which impacted some 200,000 contracts. The burden due to the difference between the exchange rates applied in November 2014 and August 2015 for mortgage credits were assumed 50–50% (HUF 15 billion each) by the banks and the Government from clients. Based on the impact of the measure, clients could sense an instalment reduction of 10% to 11% with the redemption of contracts, and one of the most important elements was that the debtors could get rid of the exchange rate fluctuation and the unreliable monthly instalments.

Thanks to the above measures, the retail foreign exchange credits were basically derecognised by the end of 2015.

2 Act XXXVIII of 2014
3 Act LXXVII of 2014
4 Act CXLV of 2015

5. Summary

The given economic environment, the emerging demand and the covering supply can be recognised in the forming and mass spreading of foreign exchange lending. During such a process, the regulator is responsible for acting proactively, then reactively, if it is insufficient. The principle of regulation is realised along consumer protection, thus offsetting the information and knowledge asymmetry between the institution and the individual taking the loan.

Regardless, during the history of foreign exchange credits, it was clearly proven that one of the pre-requisites of the success of regulatory steps is the ability to accept, i.e. whether the concerned scope of clients react to a step in large numbers, exercise the opportunity, or participate in the supporting program.

During the presented period, numerous regulatory steps were taken. The success of regulatory steps was growing, as the impact of the economic processes in the instalments informed the clients about the trend and the negative process, basically made them act. The sturdiness of regulatory steps also strengthened over time, while the scale of the problem rose to a level, where it did not only appear as a problem for the concerned parties, but the considerable amount of outsourced foreign exchange also increased the vulnerability of the entire economy. The final step was enabled in this period by the decision of the Curia, the regulatory steps taken as a consequence of which basically concluded the vulnerability of the population, the financial sector and the government due to foreign exchange credits.

APPENDICES

ACT XXXVIII OF 2014
on settling certain issues relating to the uniformity decision of the Curia in respect of consumer loan contracts entered into with financial institutions

The National Assembly, in order to satisfy certain requirements derived from the civil law uniformity decision No. 2/2014 of the Curia and to prepare further measures, adopts the following Act:

1. General provisions

Section 1 (1) The scope of this Act shall cover consumer loan contracts concluded in the period between 1 May 2004 and the day of the entry into force of this Act. For the purposes of this Act, consumer loan contracts are credit or loan contracts or financial lease contracts, established between a financial institution and a consumer, based on foreign exchange (registered in foreign currency or disbursed in foreign currency and repaid in forints) or on forint, if a standard contract term or a contract term not negotiated individually, containing a clause under section 3 (1) or section 4 (1) became part of it.

(1a) For the purposes of this Act, consumer loan contracts mean, in addition to those specified under paragraph (1), foreign exchange credit or loan contracts or financial lease contracts, established between a financial institution and a consumer, not considered as based on foreign exchange, if concluded in the period between the dates referred to in paragraph (1), and a standard contract term or a contract term not negotiated individually, containing a clause under section 4 (1) became part of it.

(2) The scope of this Act shall not cover:

a) loan contracts linked to a credit card or payment account and

b) forint-based housing loan contracts with interest subsidy provided by the State.

(3) With respect to consumer loan contracts effective on the day of the entry into force of this Act, the obligations and rights specified in this Act shall be imposed upon or be due to the financial institution which is, on the day of the entry into force of this Act, the holder of the claim originating from the consumer loan contract. If, on the day of the entry into force of this Act, the claim originating from the consumer loan contract are not due to any financial institution, the obligations and rights specified in this Act shall be imposed upon or be due to the financial institution from which the non-financial institution acquired the claim. If the consumer loan contract terminated before the day of the entry into force of this Act, the obligations and rights shall be imposed upon or be due to the financial institution which was the holder of the claim on the day when the contract terminated. If, upon the termination of the contract the holder of the claim was not a financial institution, the

obligations and rights specified in this Act shall be imposed upon or be due to the financial institution from which the non-financial institution acquired the claim.

(4) If the financial institution is being wound up or liquidated, the obligations specified in this Act shall be imposed upon the administrator or the liquidator. The liquidator's final statement of accounts, or regarding winding-up, the financial report covering the period of the winding-up may be drawn up if the settlement obligations specified in this Act and in a separate Act have been complied with. As regards settlements in procedures specified by a separate Act, consumers' claims and the reimbursement claim due to the National Asset Management Company shall be registered and confirmed by the liquidator or the administrator as acknowledged claims, without a separate announcement by the creditor. If, in respect of a settlement obligation or related to it, a review procedure or an action specified in a separate Act is launched, within sixty days after the completion of the proceedings as specified in a separate Act, the creditors' claims established on the basis of such proceedings shall be registered and the parties concerned shall be sent a confirmation of it.

(5) For the purpose of implementing this Act, the financial institutions that are involved in the change in the position of creditor in the consumer loan contract shall be obliged to cooperate. Under the obligation to cooperate, the financial institution which is the former creditor shall provide the data necessary to comply with this Act to the financial institution specified under paragraph (3). In this context, the provisions relating to banking secrecy as laid down in a separate Act shall not apply to financial institutions in their relationships with one another.

(6) The provisions of Act IV of 1959 on the Civil Code concerning the statute of limitation shall be interpreted regarding claims originating from consumer loan contracts as claims that do not expire during the existence of the loan contract, and the limitation period shall commence when the contract terminates.

(7) The limitation period of the claim under paragraph (6) shall be suspended from the day of the entry into force of this Act until the date specified in a separate Act referred to in sections 3 (5) and 4 (3).

(7a) Where the claim originates from a consumer loan contract under paragraph (1a), the limitation period of the claim under paragraph (6) shall be suspended from the day of the entry into force of this provision until the date specified in a separate Act referred to in sections 3 (5) and 4 (3).

2. Interpretative provisions

Section 2 For the purposes of this Act:

1. consumer means a consumer as defined in point 28 of section 6 (1) of Act CCXXXVII of 2013 on credit institutions and financial undertakings (hereinafter the "Hpt."),

2. financial institution means a financial institution as defined in section 7 (1) of the Hpt.,

3. financial lease contract means a contract complying with the conditions specified in point 89 of section 6 (1) of the Hpt.

3. Settling the exchange rate margin

Section 3 (1) In the consumer loan contract, with the exception of the individually negotiated contract term, the clause under which the financial institution applies the buying rate when disbursing the financing for the purchase of the borrowed or leased object, while for the repayment of the debt it applies the selling rate or an exchange rate other than the exchange rate specified when the disbursement was made shall be null and void.

(2) With the exception specified in paragraph (3), the clause qualified as null and void under paragraph (1) shall be replaced by a provision prescribing the application of the official foreign exchange rate of the Hungarian National Bank, both in terms of disbursement and repayment (including the payment of the instalment and any cost, fee or commission denominated in foreign currency).

(3) With respect to contracts specified in section 200/A of Act CXII of 1996 on credit institutions and financial undertakings or in section 267 of the Hpt. if, under those provisions, a provision on the application of the foreign exchange rate as indicated in those provisions became part of the contract, or the parties proceeded accordingly in the course of repayment, the prescription laid down in paragraph (2) concerning the foreign exchange rate shall only apply to disbursement in respect of these contracts and the period of repayment affected by these provisions.

(4)

(5) The financial institution shall be obliged to make a settlement with the consumer as specified in a separate Act.

(6)

4. Settling contract clauses providing the opportunity to amend the contract unilaterally

Section 4 (1) With respect to consumer loan contracts providing the opportunity to amend the contract unilaterally, contract clauses, with the exception of individually negotiated terms, allowing the unilateral increase of interest, cost or fee shall be presumed unfair given that it do not comply with the following principles:

a) the principle of clear and intelligible drafting: its content is not clear and comprehensible for the consumer;

b) the principle of taxonomic definition: the conditions of the unilateral amendment of the contract are not defined taxonomically, that is the list of grounds is missing or there is a list of grounds, but it is not exhaustive;

c) the principle of objectivity: the conditions of unilateral amendment are not objective, therefore the party entering into a contract with the consumer has the means to induce the occurrence of the condition and to contribute to that and to influence the extent of the change which gives rise to the amendment;

d) the principle of factuality and proportionality: the circumstances specified in the list of grounds do not actually affect the interest, the cost or the fee, or their impact is not proportionate with the extent to which circumstances have changed;

e) the principle of transparency: the consumer could not foresee under what conditions and to what extent he can be imposed upon further burdens;

f) the principle of terminability: the consumer is not granted the right to terminate the contract for the event of an amendment, or

g) the principle of symmetry: it excludes that changes which are to the consumer's advantage be exploited to the consumer's benefit.

(2) The contract clause under paragraph (1) shall be null and void if the financial institution failed to initiate civil proceedings within the time limit specified under section 8 (1) or the court dismisses the action or terminates the proceedings, except if a proceedings can be launched pursuant to section 6 (2) in respect of the contract clause, but the proceedings were not launched or the proceedings were launched but the court did not establish the nullity of the contract clause according to paragraph (2a).

(2a) The contract clause referred to in paragraph (1) shall be null and void if its nullity was established by the court in the proceeding initiated by means of an action in the public interest by the Supervising Authority pursuant to a separate Act on settlement.

(3) In cases referred to in paragraphs (2) and (2a), the financial institution shall be obliged to make the settlement with the consumer in the manner defined in a separate Act.

5. Standard contract terms and contract terms not negotiated individually and providing data in respect of these terms

Section 5 (1) The financial institution shall, within thirty days after the entry into force of this Act, examine the standard contract terms and contract terms not negotiated individually becoming part of the consumer loan contract (hereinafter jointly "SCT"), which contain the clause providing for the opportunity to amend the contract unilaterally.

(2) The financial institution shall, within thirty days after the entry into force of this Act, notify the Hungarian National Bank acting in its functions of supervision and consumer protection (hereinafter "Supervising Authority") of all the SCTs that contains a contract clause under paragraph (1) and shall make a statement as to whether or not it considers the contract clause contained therein fair or unfair. The statement to be submitted to the Supervising Authority shall be accompanied by the identification number of the contracts affected by the contract clauses and the amount of outstanding claims originating from the contract concerned.

(3) The financial institutions shall examine, until 30 November 2014, the SCTs becoming part of consumer loan contracts under section 1 (1a), which contain a contract clause providing for the opportunity to amend the contract unilaterally.

(4) The financial institution shall notify the Supervising Authority, until 30 November 2014, of all the SCTs which contain contract clauses specified under paragraph (3), and

shall make a statement as to whether or not it considers the contract clauses contained therein fair or unfair; furthermore the financial institution shall make a statement as to whether a unilateral amendment of the contract led to the increase of interest, fee or costs. The statement to be submitted to the Supervising Authority shall be accompanied by the identification number of the contract affected by the contract clauses and the amount of outstanding claims originating from the contract concerned.

Section 6 (1) If the financial institution, in the course of the examination, establishes that any of the SCTs it applies contains a contract clause which, pursuant to the provision under section 4 (1), should be presumed unfair, but the financial institution is of the opinion that the contract clause is fair, unless otherwise specified in paragraph (2), it may initiate civil proceedings in accordance with the provisions in subtitle 6 for the rebuttal of the presumption.

(2) Regarding forint-based consumer loan contracts or consumer loan contracts under section 1(1a), the unfairness of SCTs published after 26 November 2010 or the amendments of SCTs that were published after 26 November 2010 shall not be presumed unfair pursuant to the provision under section 4 (1). The Supervising Authority may carry out the procedures under Act CXXXIX of 2013 on the Hungarian National Bank, and between 14 February and 30 April 2015, initiate legal proceedings by means of an action in the public interest ex officio. The proceedings launched by means of an action in the public interest shall be governed by the provisions of the Act on the rules of settlement regulated in Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of the consumer loan contracts entered into with financial institutions and on certain other provisions.

6. Civil proceedings

Section 7 (1) To civil proceedings under this subtitle the provisions of Act III of 1952 on civil procedure (hereinafter "Pp.") shall apply subject to the derogations laid down in this subtitle.

(2) In the civil proceedings, the defendant shall be the Hungarian State, section 3:405 (2) of Act V of 2013 on the Civil Code shall apply to its representation.

(3) Legal representation shall be mandatory in the civil proceedings.

(4) The court shall proceed with priority in the civil proceedings.

(5) The writ of summons and the other judicial documents in the proceedings shall be served by an employee of the court. The employee of the court shall serve the documents on working days between 8 a.m. and 6 p.m. The parties shall ensure that the persons entitled to receive the writ of summons and other court documents are available to be served with such documents in that period. The court employee serving documents shall make a note of the service of documents, which shall in all cases contain the name of the court, the date of the service of the court document (year, month, day, hour and minute), the number of the court case and the signature of the court employee. If the service was successful, the note shall contain the signature of the person on whom the documents were served as well. If the

person entitled to receive the documents refused to receive the documents, this fact should also be referred to in the note. If the service of the documents is unsuccessful at the first attempt because the person entitled to receive the documents did not receive the document, the note shall also refer to this fact. If the person entitled to receive the document did not receive the writ of summons and all the other court documents, the court employee serving documents shall make a second attempt to serve the documents not earlier than at least one hour after the first delivery and the rules of the first delivery shall apply to that delivery. If the person entitled to receive the documents refused to receive the documents, the writ of summons and other court documents shall be considered as served on the day when service was done. If the person entitled to receive the documents does not receive the document, the writ of summons and the other court documents shall be deemed as served on the day following the second service attempt. No request for the rebuttal of the presumption of service may be submitted.

(6) In the proceeding, the court shall not be required to inform the parties of the facts to be proved in order that be capable of adjudication, the burden of proof and the consequences of unsuccessful evidencing in advance.

(7) The following shall not be possible in the legal proceedings:

a) intervening,

b) amending the action,

c) counterclaim,

d) staying,

e) application of section 104/A (1) of the Pp.,

f) application of section 121/A (1) to (3) of the Pp.,

g) issuing a default judgement,

h) remedy of deficiencies,

i) cross-appeal and cross review application,

j) application of Chapter XXVIII of Pp.,

k) retrial.

Section 8 (1) The financial institution's statement of claim initiating the civil proceedings under section 6 shall arrive at the court

a) within thirty days after the entry into force of this Act if the SCT clause subjected to the civil proceedings was applied to a foreign exchange-based credit or loan contract (registered in foreign currency or disbursed in foreign currency and repaid in forints) or financial lease contract,

b) between 5 and 12 January 2015 if the SCT clause subjected to the civil proceeding was applied to a HUF-based credit or loan contract, financial lease contract on 26 November 2010 or before that,

c) between 5 and 12 January 2015 if the SCT clause subjected to the civil proceeding was applied to a consumer loan contract specified in section 1 (1a) on 26 November 2010 or before that;

the time limit shall be deemed as term of preclusion.

(1a) If the statement of claim, in cases under paragraph (1) b) or c), was received by the court before 5 January 2015, it shall not be rejected on this ground, but shall be deemed as submitted on 5 January 2015.

(2) No excuse may be submitted for the failure to respect the time limit specified in paragraph (1).

(3) The financial institution shall, with the derogation specified in paragraph (3a), request, in the same statement of claim, the establishment of the validity of all the contract clauses under section 4 (1) of the SCTs the financial institution applies. In the statement of claim, the financial institution shall specify the period during which it applied the contract clause.

(3a) The financial institution shall, in the same statement of claim, request the establishment of the validity of all the contract clauses under section 4 (1) of the SCTs the financial institution applies, regarding which the statement of claim shall be received by the court between 5 and 12 January 2015. In the statement of claim, the financial institution shall also specify the period during which it applied the contract clause.

(4) In the statement of claim, the financial institution may request only the establishment of what is specified in section 11 (3).

(5) In addition to what is specified in section 121 (2) and (3) of the Pp., the extract of STCs, under paragraph (3), included in the same deed containing only those contract clauses that are subject of the request for the establishment of validity, and specifying the period during which the financial institution applied those, shall be attached to the statement of claim. In the extract, in addition to individual contract terms, the facts and evidences which, according to the financial institution, give grounds for what is included in the statement of claim. Furthermore, an electronic medium containing the statement of claim and its attachments in an editable format, edited by means of an IT tool shall be attached to the statement of claim.

(6) If the statement of claim is rejected pursuant to section 130 of Pp., the legal effects pertaining to the submission of a statement of claim will prevail if the plaintiff duly resubmits the statement of claim within five days from the rejection becoming final and binding.

(7) The court fee of the first instance civil proceeding shall amount to HUF 1,500,000.

Section 9 (1) The proceeding shall fall under the exclusive material and territorial jurisdiction of the Budapest-Capital Regional Court.

(2) The court of first instance, if it is justified by the complexity of the proceeding, may order, prior to the commencement of the hearing, that in the proceedings a panel consisting of three professional judges proceed. If the court referred the proceeding to a panel, later no single judge may proceed in the proceedings.

(3) The court shall adjudicate the action within thirty days.

Section 10 (1) The date of the hearing shall be set in a way to make it possible for the statement of claim to be served on the defendant at least three days before the hearing.

(2) The date of the hearing shall be set no later than on the eighth day after the statement of claim was received by the court.

(3) Only such evidence that is available at the hearing and that might be suitable to prove the allegations presented in the statement of claim or justify the defence of the defendant may be taken. Evidence which is offered by the parties promptly may also be taken.

(4) The hearing may only be postponed, once, for no more than seven days, and only if it is necessary in order to carry out the taking of evidence offered by the parties.

(5) If the party or his representative fails to appear at the hearing for reasons beyond their control but submits an application for excuse, the application may be submitted on the first working day following the date missed at the latest. The person submitting the application for excuse may appeal the order rejecting the application for excuse within three days. The court shall refer the appeal to the court of second instance within one working day, without obtaining the comments of the counterparty of the party submitting the appeal. The court of second instance shall decide upon the appeal within three days of its referral.

(6) The court, in cases under section 8 (1) b) and c), shall examine the statement of claim within thirty days from its arrival and decide whether to reject it without issuing a writ of summons or set the date of a hearing. If the court does not reject the statement of claim without issuing a writ of summons, the time limit specified in section 9 (3) shall commence on the date when the date of the hearing is set.

Section 11 (1) In the proceeding, the court shall examine only whether the contract clause considered fair by the financial institution is fair in view of section 4 (1).

(2) If the court establishes that the contract clause considered fair by the financial institution does not comply with any of the conditions specified in section 4 (1) and therefore is unfair, the court shall dismiss the claim.

(3) If the court establishes that the contract clause considered fair by the financial institution complies with all conditions specified in section 4 (1), it shall establish that the contract term is fair and therefore valid.

Section 12 (1) The court may postpone the announcement of the judgment for no more than fifteen days.

(2) The decision of first instance, except if its announcement was postponed by the court, shall be committed to writing no later than within eight days from the time when it was taken and shall be served within three days of it being committed to writing. If the court has postponed the announcement of the judgment, the court shall promptly serve the written judgment on the parties present when the announcement is made and this fact shall also be included in the minutes, and parties not present shall be served with it within three days.

Section 13 (1) The time limit for appeal is eight days from the time when the decision is communicated.

(2) The court fee for the appeal against the judgement shall amount to HUF 2,500,000.

(3) If the appeal does not comply with the provisions of the Pp., or the applicant failed to comply with the obligation to pay the court fee, the court shall dismiss the appeal without calling upon the party to remedy the deficiencies. If there is no ground for dismissal and the time limit for appeal has expired in respect of all parties, or if app parties submitted their appeal without deficiencies, the court of first instance shall refer it to the court of second instance together with all the documents relating to the case no later than within three days.

(4) The court shall adjudicate the appeal within thirty days from its referral set out in paragraph (3).

(5) The hearing date shall be set in a way which makes it possible for the appeal to be served on the opposing party at least three days before the day of the hearing. The appeal against the decision shall be adjudicated by the court at a hearing.

(6) The court shall set the hearing date no later than on the fifteenth day from the date when the documents arrive at the court of second instance.

(7) The counter appeal shall be submitted to the court of second instance at the hearing at the latest. The hearing may be postponed once, for no more than seven days.

Section 14 (1) The decision bringing the second instance proceeding to an end, shall be committed to writing not later than within eight days from the time when it was taken, except if the court has postponed its announcement. The decision bringing the proceedings of second instance to an end shall be served on the parties by the court of second instance within three days. The court of second instance shall return the documents to the court of first instance if no review application was submitted against the judgement. If the court of second instance set aside the decision taken by the court of first instance, the court of second instance shall send the documents to the court of first instance after the completion of the proceedings of second instance not later than within three days after the decision was committed to writing.

(2) If the court of second instance postponed the announcement of the judgment, judgment already committed to writing shall be served on the parties present and shall include this fact in the minutes.

Section 15 (1) The review application shall be submitted to the court of second instance having taken the decision within eight days from the date when the decision was communicated, or it shall be sent, in two more copies than the number of parties concerned in the action, by post in a registered mail.

(2) The court fee for the review of the judgment shall amount to HUF 3,500,000.

(3) If the time limit open for submitting the review application has expired for all parties or all the parties submitted review application, the court of second instance shall refer the application together with the documents of the case to the Curia without delay, but not later than within three days.

(4) The Curia shall carry out the review procedure within thirty days from the referral specified in paragraph (3).

(5) The Curia, except if deeming it necessary to adjudge the review application at a hearing, shall adjudicate the review application outside a hearing. The Curia, if it deems the adjudication of the review application necessary at a hearing, shall set the hearing date not later than the eighth day after the documents have been received by it. The hearing date shall be set in a way which makes it possible for the review application to be served on the opposing party at least three days before the day of the hearing.

(6) The decision bringing the review procedure to an end, except if the Curia has postponed its announcement, shall be committed to writing not later than within eight days from the date when it was taken, and served upon the parties by the Curia within three days. The Curia, if ordering the court of first or second instance to carry out a new procedure and

take a new decision, shall send the documents to the court within three days after it was committed to writing. If the Curia has postponed the announcement of the judgment, it shall promptly serve its judgment having already been committed to writing on the parties present and shall include this fact in the minutes as well.

7. Managing pending actions

Section 16 (1) The court, until the measure specified in a separate Act, but until not later than 31 December 2014, shall ex officio suspend, with the exception of proceedings initiated by an action in the public interest set out in section 6 (2) and proceedings regulated in subtitle 6,proceedings the subject of which, in part or in full, is a contract clause specified under section 3 (1) or section 4 (1), or proceedings initiated by the financial institution against the consumer in order to enforce a claim originating from such a contract term. The court may also decide upon suspension without a hearing. Section 155 of the Pp. shall accordingly apply to the suspension of proceedings with the proviso that the court decision suspending the proceedings may not be appealed.

(2) The court, until the measure specified in a separate Act, but not later than 31 December 2015 shall ex officio suspend the action, with the exception of proceedings initiated by an action in the public interest under section 6 (2) and proceedings regulated in subtitle 6, the subject of which, in part or in full, is a contract clause specified under 4 (1) or a proceedings which was initiated by the financial institution against a consumer in order to enforce a claim which originates from such a contract clause, if the contract clause specified in section 4 (1) is included in the consumer loan contract specified in section 1 (1a). The rules specified in paragraph (1) shall apply to suspension.

8. Derogating from the rules of Act LIII of 1994 on judicial enforcement

Section 17 (1) The provisions of the Act LIII of 1994 on judicial enforcement (hereinafter "Vht.") shall be applied subject to the derogations laid down in this section.

(2) For the purposes of this section, loan contracts mean a foreign exchange or HUF-based credit or loan contract, financial lease contract concluded between the financial institution and the consumer as a debtor or co-debtor.

(2a) For the purposes of this section, in addition to paragraph (2), loan contract means a foreign exchange credit or loan contract not considered as foreign exchange-based contract and financial lease contract concluded by the financial institution and the consumer as a debtor or co-debtor.

(3) In pending enforcement proceedings initiated for the collection of claims that are based on a loan contract (or initiated upon the creditor joining the enforcement procedure in order to enforce a claim originating from a loan contract), with the exceptions specified in paragraphs (4), (7), (8) and (10), no procedural action or measure may be taken until the date specified in the separate Act, the statements made by parties and other interested parties

shall also be ineffective; until this date, all time limits shall be suspended and after that date all time limit shall commences again. If there has been no procedural action or measures pursuant to this Act, the case shall be registered by the bailiff as a staying case.

(4) If the asset identified as coverage for the claim subject to the loan contract (hereinafter in this section "asset defined as coverage") was sold, before the entry into force of this Act,

a) in an auction held in a judicial enforcement proceeding, through the taking over by the party requesting the enforcement, or through sale other than an auction but with the effects of an auction, or

b) outside judicial enforcement,

in the pending judicial enforcement related to this asset defined as coverage, the legal remedy relating to the sale of the asset defined as coverage, and the procedural actions relating to the vacation or giving into possession of the asset defined as coverage, shall be taken by the bailiff in consideration of the provisions in section 303 of the Vht., and those may also be initiated by the parties and other interested parties participating in the enforcement.

(5) If enforcement was initiated against the debtor in addition to the enforcement of the claim specified in paragraph (3) [or commenced upon the creditor joining the enforcement procedure in addition to the enforcement of the claim specified in paragraph 3], in these enforcement proceedings, until the date specified in the separate Act, with the exception of the seizure of the asset and with the exception of procedural actions specified in paragraph (4), no measures or procedural actions may be taken with respect to the asset defined as coverage.

(6) The provisions of this section shall apply to those enforcement proceedings in which

a) the subject of the enforcement procedure is the enforcement of a pledge contract securing the claim originating from the loan contract or a declaration of suretyship,

b) the party requesting the enforcement or the debtor is the legal successor of a party to the loan contract or the contract securing the claim originating from the loan contract.

(7) The party requesting the enforcement and the debtor may request the establishment of the absence of a contract clause specified in section 3 (1) or section 4 (1) from the loan contract. be established. The request or application shall be submitted to the bailiff who, for the purposes of adjudication, shall refer that together with the documents of the case to the court carrying out the enforcement. The application shall be adjudicated by the court carrying out the enforcement according to the rules concerning the adjudication of enforcement objections.

(8) If establishing that the loan contract does not contain the contract clause specified under section 3 (1) or section 4 (1), the court carrying out the enforcement shall decide, in an order, that, upon its becoming final and binding, paragraphs (3) - (6) cannot be applied and the procedural actions and measures may be carried out; suspended time limits shall commence again after the order has become final and binding.

(9) If, on the day of the entry into force of this Act, the enforcement procedure initiated to collect the claim originating from the loan contract is staying because

a) the debtor was granted instalment payment, or

b) the employer (the organ disbursing the remuneration) confirmed that the deduction was registered and taking other measures is neither possible or necessary, the debtor may request the bailiff that paragraph (3) be applied.

(10) The provisions of this Act shall not prevent:

a) the debtor from paying the amount of the claim, or

b) that the termination or reduction of the claim be announced, or procedural actions or measures linked to the termination or reduction of the claim be taken,

c) that enforcement be ordered (the application for joining the enforcement proceedings be decided upon) regarding loan contacts, or procedural actions or statements related to ordering enforcement (to assessing the application for joining the enforcement proceedings) be made.

9. Derogating from the rules of the Government Decree on the sale of pledged liens outside judicial enforcement

Section 18 (1) The provisions of Government Decree 12/2003 (I. 30.) Korm. on the rules of the sale of pledged lien outside judicial enforcement and Government Decree 66/2014 (III. 13.) Korm. on the detailed procedural rules on enforcing lien outside judicial enforcement and the suspension and limitation of exercising the right to satisfaction shall apply subject to derogations laid down in this section.

(2) Up until the date specified in the separate Act, pledged items securing, upon lien, claims originating from consumer loan contracts shall not be sold, by applying sections 257 to 258 of Act IV of 1959 on the Civil Code and sections 5:127 to 5:135 of Act V of 2013 on the Civil Code, and an auction notice may only be published on the Electronic Auction Surface following this date.

10. Final and transitional provisions

Section 19 (1) Subject to the derogation specified in paragraph (2), this Act shall enter into force on the day following its promulgation.

(2) Sections 1 to 18 shall enter into force on the eighth day following the promulgation.

Section 20 The financial institution shall not have the right to unilaterally increase the interest, cost or fee regarding consumer loan contracts as of the day when this Act enters into until the competent court establishes the fairness of the SCT concerned, irrespective of whether the financial institution has published a notice concerning a unilateral increase of interest, cost or fee pursuant to section 279 (8) of the Hpt.

Section 21 If the financial institution published, pursuant to section 279 (8) of the Hpt., the notice on unilateral increase of interest, cost or fee before 17 June 2014. and the planned unilateral increase of interest, cost or fee included therein took effect after 16 June 2014 but not later than on the day of the entry into force of this Act, and

a) no repayment was made after the amendment, the financial institution shall not enforce the amendment regarding the instalment to be paid and shall withdraw the notice;

b) repayment was made after the amendment, the instalment increased due to the amendment shall be credited to the account of the client on the third working day following the entry into force of this Act and the notice shall be withdrawn.

Section 22 (1) If the application for enforcement (for adjudicating the application for joining the enforcement procedure) regarding a loan contract under section 17 (2) was submitted after 26 July 2014 and the enforcement was not ordered until 15 October 2014 (the application for joining the enforcement procedure was not adjudicated), enforcement (adjudication of the application for joining the enforcement procedure) shall be ordered until 15 December 2014.

(2) Regarding loan contracts specified in section 1(2) of this Act provided for by Act XL of 2014 on the rules of settlement regulated in Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of the consumer loan contracts entered into with financial institutions, and certain other provisions (hereinafter the "Amending Act"), proceedings suspended pursuant to section 16, at the request of the party, shall be continued; the court shall arrange for continuing the proceeding within thirty days from receiving the application.

(3) Regarding loan contracts specified in section 1 (2) of this Act provided for by the Amending Act, the party requesting the enforcement or the debtor may request the proceedings specified in paragraphs (7) to (8) of section 17 be conducted, and the application shall be assessed by the court with priority.

(4) Regarding loan contracts specified in section 1 (2) of this Act provided for by the Amending Act, the rules laid down in section 18 shall not apply as of 15 December 2014.

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on the rules of settlement regulated in Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of the consumer loan contracts entered into by financial institutions, and certain other provisions

1. General provisions

Section 1 The scope of this Act shall cover the consumer loan contracts covered by Act XXXVIII of 2014 on settling certain issues relating to the uniformity decision of the Curia in respect of the consumer loan contracts entered into by financial institutions (hereinafter "Act XXXVIII of 2014").

2. Interpretative provisions

Section 2 For the purposes of this Act:

1. General Terms and Conditions means the General Terms and Conditions as defined in section 5 (1) of Act XXXVIII of 2014,

2. consumer means a consumer as defined in section 2 point 1 of Act XXXVIII of 2014,

3. consumer loan contract means a contract as defined in section 1 (1) and (1a) of Act XXXVIII of 2014,

4. financial institution means a financial institution as defined in section 2 2 of Act XXXVIII of 2014,

5. financial lease contract means a financial lease contract as defined in section 2 3 of Act XXXVIII of 2014.

3. Principles of settlement

Section 3 (1) If a void clause under section 3 (1) of Act XXXVIII of 2014 was applied, the amount of the difference between the loan having been disbursed pursuant to the void clause and converted under paragraph (2), and the amount of the difference between instalments having been paid in line with the void clause and converted under paragraph (2) shall be credited to the consumer as overpayment originating from an exchange rate margin.

(2) The financial institution shall convert the amount of the loan disbursed by it and then, with the exception laid down in paragraph (3),the amount of instalments at the official foreign exchange rate, effective on the day when the settlement was made, published by the Hungarian National Bank. If the financial institution specifies a day for conversion in its General Terms and Conditions or its contracts, then the conversion shall be made applying the official foreign exchange rate, effective on the day of such conversion, published by the Hungarian National Bank.

(3) In the cases and for the period defined by section 3 (3) of Act XXXVIII of 2014, the official foreign exchange rate published by the Hungarian National Bank shall not be applied

if the financial institution applied, in compliance with the provisions laid down in Acts, a foreign exchange rate having become part of the contract.

Section 4 (1) If a void clause under section 4 (2) of Act XXXVIII of 2014 was applied, the amount of difference between instalments paid pursuant to the void clause and calculated without the increased interest, interest premium (hereinafter together referred to as "interest") cost and fee being taken into account shall be credited to the benefit of the consumer as overpayment originating from the unilateral amendment of the contract.

(2) The financial institution increasing the interest, cost and fee unilaterally to the rate specified in the contract upon terminating interest, cost and fee reduction granted for a period specified in advance shall not be considered as unilateral amendment of the contract under paragraph (1).

(3) The settlement shall be made on the basis of the rate of interest, cost and fee, which became part of the contract upon the expiry of the preferential period specified in the contract or in paragraph (2).

(4) The amount of overpayment originating from the unilateral amendment of the contract may not be reduced with regard to reduced interest rate, cost and fee under paragraph (3) even if it was due to a unilateral amendment of a contract. Section 5 (5) and (6) shall apply if the reduction was due to a mandatory legal provision or the fee or the cost was reduced simultaneously with the increase of the interest rate to the extent provided by law or while interest rate increased the fee or the cost was reduced.

(5) A unilateral modification of the General Terms and Conditions by which the financial institution amends the void clause related to the unilateral amendment of the contract shall not become part of the consumer loan contract having been concluded before the amendment.

(6) The provision of this section shall apply if the contract clause relating to the unilateral amendment of the contract is invalid for any other reason.

4. Rules of settlement

Section 5 (1) If, due to the nullity of contract clauses, settlements specified in section 3 and section 4 are both to be carried out, the settlement of overpayment arising from the exchange rate margin and from the unilateral amendment of the contract (hereinafter together "overpayment") shall be done simultaneously and in conjunction.

(2) During the term of the consumer loan contract, the consumer's claim shall be calculated according to the decree issued by the Governor of the Hungarian National Bank upon the authorisation of this Act (hereinafter "MNB Decree") taking as if overpayments under section 3 and section 4 had been paid as prepayments at the time of overpayment, or if the prepayment was made after the due date, at the following due date (hereinafter "consumer's claim").

(3) The consumer's claim, with the exception of paragraph (4),shall be, in accordance with the general provisions of civil law, used to settle the costs in the first place then the interest and finally the principal. If the consumer's claim exceeds the debt of the consumer payable

to the financial institution, that shall be settled as prepayment at the date and in the manner specified in the MNB Decree. The financial institution subject to settlement obligation might unilaterally derogate from the order of settlement specified in this paragraph in favour of the consumer.

(4) If the consumer loan contract was terminated with the obligation to settle the claim originating from the contract not existing any further, the payments that were not due following the termination of the contract shall be settled in line with the rules on unjustified enrichment, according to which those shall be refunded in an amount increased with the base rate and for foreign exchange payments that were not due, in an amount increased with the money market interest rate applicable to the given foreign exchange as specified in the MNB Decree.

(5) The financial institution subject to the settlement obligation, in the course of the settlement, shall be entitled to deduct, with the exception of the reductions to promote the conclusion of the contract, from the amount of the consumer's claim the reduction provided in the given period taking into account the date when the reduction was provided.

(6) Reduction as specified in paragraph (5) shall include all financial advantage and benefits based on a contract amendment, the practice of the parties in their relationship, mandatory legal provision or court decision, which originate from the fact that the financial institution provided a principal, interest or fee waiver to the consumer during the period of the consumer's payment obligation or granted a preferential exchange rate, as a result of which the payment obligation of the consumer was reduced compared to the payment obligation provided for in the contract. The method of settling the reductions and discounts deductible from the consumer's claim is laid down in the MNB Decree.

(7) Specifying the new instalment shall form part of the settlement.

(8) In the course of settling overpayment as consumer's claim

a) the one-off fee or cost paid by the consumer in connection with the disbursement of the loan or the credit rating as laid down in the consumer loan contract,

b) the regular fee or cost paid by the consumer in the repayment periods as laid down in the consumer loan contract,

c) regarding prepayment, the prepayment surcharge paid by the consumer

shall be taken into account.

(9) If the consumer loan contract is terminated as a result of a loan substitution provided by the same financial institution and the consumer has debts toward the financial institution as a result of the consumer loan contract concluded for the purpose of loan substitution, the consumer loan shall be settled against the creditor's claim that originates from the consumer loan contract concluded for the purpose of loan substitution.

5. Other rules affecting the settlement obligation

Section 6 (1) Financial institutions shall be subject to settlement obligation in respect of consumer loan contracts that have not terminated and consumer loan contracts terminated after 26 July 2009.

(2) In respect of contracts terminated on 26 July 2009 or before, the financial institution shall be subject to settlement obligation if it is aware of the fact that the claim has not lapsed.

(3) The financial institution shall, at the request of the consumer, settle in respect of a contract terminated on 26 July 2009 or before, if the consumer proves that the assigned claim of the financial institution is required to be enforced against the consumer by a financial institution that is not subject to the settlement obligation (hereinafter "claim manager").

(4) The financial institution shall also be obliged to settle accounts with the consumer if the consumer alleges and the financial institution does not contest that the claim of the consumer arising from this Act has not expired or this fact has been established in a final and binding court judgment.

(5) For foreign exchange-based consumer loan contract under section 1 (1) of Act XXXVIII of 2014 and consumer loan contracts under section 1 (1a) the effective date of settling consumer's claim shall be 1 February 2015. For forint-based consumer loan contracts under section 1 paragraph (1) of Act XXXVIII of 2014, the effective date of settling the consumer's claim shall be 30 June 2015.

(5a) If, in the consumer loan contract, there was a change in the position of consumer, the financial institution shall have to settle accounts with the consumer it is in a contractual relationship with at the time of the settlement.

(6) The final and binding judgment of the court concerning the claims originating from the consumer loan contract subject to the settlement shall be without prejudice to the financial institution's settlement obligation except if the final and binding court judgment established the invalidity of the contract and it has not been declared valid or, for the period until the a decision is rendered, effective by the court.

(7) The financial institution which is not subject to the settlement obligation but is the holder of the seceded lien established with respect to the consumer loan contract shall have a joint and several liability for the payment obligation originating from the consumer's claim.

(8) If the financial institution established a seceded lien with respect to the pledged item offered in respect of the consumer loan contract, the holder of the claim originating from the consumer loan contract shall inform the holder of the seceded lien in writing of the termination of the claim immediately and the holder of the succeeded lien immediately shall take measures to have the seceded lien deleted from the registry.

(9) If, regarding a financial institution subjected to a winding up or liquidation procedure, the information necessary for the settlement is not available in full, the estimation method defined in the MNB Decree shall be applied to the settlement.

(10) If the financial institution, not subjected to a winding up or liquidation procedure, which is subject to the settlement obligation does not have the information necessary for the settlement available in full and the financial institution is able to prove it to the Supervising Authority, it may proceed according to the estimation method approved by the Supervising Authority in respect of the consumer loan contract concerned.

(11) The Hungarian National Bank, in a consumer protection proceeding, checks whether the financial institution not subjected to winding up or liquidation procedure applies the estimation method appropriately if conditions pursuant to paragraph (10) are met.

(12) The consumer shall have the right to request settlement within a limitation period of six months pursuant to paragraph (3). The starting date of the limitation shall be the first day of the second month following the publication on the website under section 16 (3).

Section 7 (1) If the financial institution subject to the settlement obligation assigned its claim against the consumer to a claim manager following the termination of the contract, the financial institution subject to the settlement obligation shall draw up the settlement under section 5 (2) on the date when the claim was assigned.

(2) For the purpose of exercising his rights originating from the settlement, the consumer may request the claim manager to make a settlement concerning its claim against the consumer according to section 5 (3), by applying accordingly section 5 (5) and (6) in respect of the reductions provided to the consumer by the claim manager or its legal predecessor. In the course of the settlement, the consumer's claim shall be, in the amount at the time of assignment increased with the interest applied by the claim manager pursuant to the provisions of the MNB Decree from the time of assignment, taken into account.

(3) If, as a result of the settlement specified in paragraph (2), the claim manager is indebted to the consumer, the debt shall be settled by the claim manager; however it shall be entitled to apply for the refund of the paid amount to the financial institution subject to the settlement obligation. The claim manager may request, from the financial institution subject to the settlement obligation, the proportionate refund of his financial loss originating from the reduction of the assigned claim compared to its purchase price. If the claim manager did not acquire the assigned claim directly from the financial institution subject to the settlement obligation, all parties shall cooperate in the settlement specified in paragraph (2).

(4) The provision of this section shall apply also if the of claim manager's claim ceased to exist upon satisfaction.

(5) The consumer shall have the right to enforce his settlement claim under paragraph (2) within a limitation period of six months. The starting date of the limitation shall be the first day of the second month following the service of the letter concerning the settlement on the consumer and prepared for the date of the assignment of the claim as per paragraph (1).

Section 8 All costs relating to the settlement shall be borne by the financial institution subject to the settlement obligation, or, if section 7 (2) applies, by the claim manager regarding what is provided for therein. The financial institution shall not be entitled to charge any additional costs and fees for performing its obligations laid down in this Act. The performance of the financial institutions' obligations specified in this Act may not serve as grounds for a unilateral contract amendment as defined in Act CCXXXVII of 2013 on credit institutions and financial enterprises (hereinafter "Hpt.")

Section 9 The staying of the limitation period of the claim originating from consumer loan contracts under section 1 paragraph (7) of Act XXXVIII of 2014 shall terminate when settlement is communicated to the consumer under this Act but no later than 31 December 2015.

Section 9/A Derogating from Act XXX of 1997 on mortgage loan companies and on mortgage bonds, in respect of a settlement under this Act the mortgage credit institution may purchase, from a financial institution under supervision on a consolidated basis, the claim against the natural person, to the obligor of which claim the mortgage credit institution provided a mortgage loan.

6. Deferring rules on settlement of the consumer loan contract in the case of early final repayment

Section 10 (1) If the obligation to fulfil the consumer loan contract was terminated upon the early final repayment under section 200/B of Act CXII of 1996 on credit institutions and financial enterprises, the financial institution shall be obliged to settle accounts with the consumer at the request of the consumer submitted under paragraph (3), taking into account section 5 (5) and (6).

(2) The result of the settlement under paragraph (1) shall not give rise to payment obligation on the part of the consumer.

(3) The consumer may request the financial institution, between 1 March and 31 March 2015, to provide him with a settlement. The consumer may request the settlement in consideration of a fee of HUF 10,000. If, as a result of the settlement, it is established that the financial institution has a payment obligation for the consumer, the financial institution shall refund the fee of HUF 10,000 to the consumer. If the consumer entered into a forint-based consumer loan contract for the purpose of an early final repayment, he will not have to pay the fee of HUF 10,000 provided that he entered into the forint-based consumer loan contract with the financial institution subject to the settlement obligation or with another financial institution, and he certifies that the purpose of concluding the forint-based consumer loan contract was to facilitate early final repayment.

7. Deferring rules on settlement regarding consumer loan contracts affected by residential properties offered to the National Asset Management Company for purchase

Section 11 (1) If the National Asset Management Company purchased the residential property offered to it by the consumer before the financial institution complied with its settlement obligation pursuant to this Act, the financial institution shall not have to settle accounts with the consumer.

(2) If the National Asset Management Company purchased the residential property offered to it by the consumer, the creditor of the consumer in the plan to divide the purchasing price may request the National Asset Management Company, until 31 December 2015, to call upon the financial institution, simultaneously with sending the consumer's request to the financial institution, to draw up the settlement and send it to the National Asset Management Company.

(3) If the purchase price having been paid to the financial institution before the announcement of the settlement, with respect to the result of the settlement and the plan to divide the purchase price modified according to it by the National Asset Management Company, exceeds the part of the purchase price payable to the financial institution, the financial institution shall refund the amount of the difference to the National Asset Management Company within the deadline specified in its notice, but no later than within 30 days. The National Asset Management Company shall be responsible for paying the refunded amount to creditors next in ranking based on the plan to divide the purchasing price.

8. Deferring rules on settlement in the case of consumer loan contracts affected by the exchange rate cap

Section 12 (1) As of the period of applying the fixed exchange rate determined pursuant to the Act on fixing the exchange rate used for repaying foreign exchange-based loans and the administration of the forced sale of residential property, section 5 (3) shall be applied to credit facility contracts in respect of loans with collection accounts in the following way: after the settlement of due and overdue debts the consumer's claim shall be settled primarily against the collection account and the remaining part shall be settled against the foreign exchange loan to which the collection account is linked. The part of the consumer's claim denominated in foreign exchange which has been settled against the collection account shall be converted to HUF at the official exchange rate, effective on the date specified in the MNB Decree, published by the MNB.

(2) Pursuant to the Act on fixing the exchange rate used for repaying foreign exchange loans and the administration of the forced sales of residential property, the amount equalling to 50% of the exempted claim that was refunded by the State shall be considered as a reduction for the purposes of section 5 (6).

(3) The application of section 5 (5) shall be subject to the derogation that the financial institution may only enforce the reduction provided in respect of the collection account when the consumer claim can no longer be settled against the collection account pursuant to paragraph (1).

8/A. Deferring rules on settlement regarding consumer loan contracts affected by bridging loans

Section 12/A (1) Pursuant to Act IV of 2009 on the first loss guarantee provided by the state concerning housing loans, in respect of instalments paid against the bridging loans and during the period of payment thereof, section 5 (3) shall apply subject to the derogation that the consumer's claim shall be settled, after the settlement of the debts that become due or are overdue in the case of a collection account, after the settling such debts against the collection account, primarily against the bridging loan, and the remaining amount shall be settled against the foreign exchange loan to which the bridging loan is linked.

(2) The part of the consumer's claim denominated in foreign currency which has been settled against the bridging loan shall be converted to HUF at the official exchange rate, effective on the date specified in the MNB Decree, published by the Hungarian National Bank.

9. Time limit for complying with the settlement obligation

Section 13 (1) Regarding foreign exchange-based (registered in foreign exchange or disbursed in foreign exchange and repaid in HUF) credit or loan contracts, financial lease contracts, the financial institution shall send the settlement to the consumer between 1 March 2015 and 30 April 2015. If the civil proceeding initiated pursuant to Act XXXVIII of 2014 is terminated after 1 March 2015, the final time limit for sending out the settlement shall be the sixtieth day following the completion of the civil proceeding.

(2) Regarding forint-based and foreign exchange credit or loan contracts not qualifying as foreign exchange-based and financial lease contracts, the financial institution shall send the settlement to the consumer between 1 August 2015 and 30 September 2015. If the civil proceeding initiated pursuant to this Act or to Act XXXVIII of 2014 by the financial institution or by the Supervising Authority was completed after 1 August 2015, the final deadline for sending out the settlement shall be the sixtieth day following the completion of the civil proceeding.

(3) In the case specified under section 10 (3), the financial institution shall send the settlement to the consumer until 30 November 2015.

(4) In the case specified under section 11 (2), the financial institution shall send the settlement to the National Asset Management Company until 28 February 2016.

(5) For the purposes of this section, the date of the completion of the civil proceeding shall be the day when the decision of the court terminating the proceedings becomes final and binding; and if a review application was submitted then the day of communicating the decision taken in the review proceedings that terminates the proceedings.

Section 14 The claim manager shall comply with the consumer's request for the settlement specified under section 7 (2) within 30 days from the submission of the consumer's request.

10. The settlement and the communication of the settlement

Section 15 If the domicile of the consumer is other than that indicated in the consumer loan contract or from the domicile last notified by the consumer, the consumer shall communicate his new domicile to the financial institution subject to the settlement obligation. The domicile shall be the address where the consumer expects mails from the financial institution.

Section 16 (1) The financial institution shall send the settlement, in a letter with acknowledgement of receipt, to the consumer, to the address indicated in the consumer loan contract or the address notified pursuant to section 15,. The date of sending shall be the date when the mail containing the settlement was stamped by the post.

(2) The settlement shall comply with the requirements as to content and form specified in the MNB Decree.

(3) If the financial institution has sent the settlement to all consumers concerned, it shall communicate this fact on its internet website within 15 days and shall simultaneously make this information available in all its branch offices. If the financial institution is obliged to settle accounts with the consumer at different dates pursuant to section 13, the disclosure shall be done in groupings according to the dates specified under section 13 after all the settlements in individual groups have been made or if no settlement is to be provided. The detailed requirements as to form and content of the disclosure shall be laid down in the MNB Decree. The financial institution's disclosure obligation shall also arise if the identity

of the heir replacing the consumer is uncertain, therefore the settlement has not been sent to him, but the settlement has been sent to all other consumers concerned.

(4) If the financial institution is not obliged to send the settlement to any debtor, surety or pledger directly, the debtor, surety or pledger may request that the copy of the settlement be sent to him by the financial institution for information. If the person entitled to receive a copy has the right to contest the settlement and the financial institution has not prepared one, the person entitled to contest the settlement may demand the drawing up of a settlement according to the rules to be applied to the consumer. The person entitled to receive a copy who is not indicated as an addressee of the settlement but who is a contracting party as a debtor or lessor (obligor) shall have the right to contest the settlement. The settlement shall be presumed to have been served on the person entitled to receive a copy when the settlement is to be presumed to have been served on the person indicated as an addressee of the settlement.

(5) If the person entitled to receive a copy has the right to contest the settlement, submitting the request for sending a copy shall not modify the time limit for submitting a complaint under section 18 (1) with respect to the person entitled to receive a copy. If the person entitled to receive a copy contests the settlement, the rules applicable to the consumer shall apply in the course of the proceedings before the financial institution, the Financial Arbitration Board and the court with respect to the person entitled to receive a copy.

(6) The person entitled to receive a copy may submit his request for a copy no later than within 30 days from publication on the website specified under section 16 (3).

Section 17 (1) If the obligation to perform the consumer loan contract was terminated before this provision entered into force and the financial institution has a payment obligation in favour of the consumer upon the settlement, the consumer shall communicate the number of the account where the amount indicated in the settlement should be transferred to, or he shall indicate that he wishes to collect the amount in a branch office of the bank, in the form of cash payment. If the consumer has a payment account held with the financial institution subject to the settlement obligation has a payment account held with a financial institution under the supervision on a consolidated basis of which the financial institution is aware based on the transfer of data at an earlier date in relation to the consumer loan contract the amount to be paid shall be credited to this payment account. If the consumer has more than one payment account held by the financial institution subject to the settlement obligation, the financial institution shall credit the payable amount to the payment account which is held under the most favourable conditions for the consumer.

(1a) The financial institution shall take measures

a) to effect the transfer within 15 days of receipt of the number of the payment account as specified under paragraph (1),

b) to credit the amount onto the account within 15 days from sending of the settlement.

(2) If the settlement is returned from the domicile indicated in the consumer loan contract notified by the consumer marked "address cannot be identified", "address unknown", "unclaimed", "refused to accept", "moved out", "delivery obstructed" or "announced as deceased", or the consumer fails to make the announcement under paragraph (1) within 30 days, the financial institution shall manage the amount payable to the consumer on a separate account as a claim subject to expiry pursuant to the general rules of civil law on

obligations. The financial institution may not charge administration fee for managing such amount on the separate account and the consumer may not claim an interest on the amount.

Section 17/A. The provider of reference data shall meet its data provision obligations pursuant to section 15 (6) of Act CXXII of 2011 on the central credit information system, relating to this Act by informing the natural person of the transfer of the data and by concurrently sending him the settlement pursuant to section 13.

11. The review of the settlement

Section 18 (1) If the consumer disputes the settlement sent him by the financial institution then, with the exception under paragraph (2),he may submit a complaint to the financial institution within thirty days from the delivery of the settlement. If the consumer was prevented from submitting a complaint, the complaint may be submitted within thirty days from the elimination of the obstacle but no later than ninety days following the time limit for submitting the complaint.

(2) If the settlement is returned from the domicile indicated in the consumer loan contract or notified by the consumer marked "address cannot be identified", "address unknown", "unclaimed", "refused to accept", "moved out", "delivery obstructed" or "announced as deceased", the complaint may be submitted within thirty days from the consumer becoming aware of the settlement; if the consumer is prevented from submitting the complaint within thirty days from the elimination of the obstacle, but, excluding the cases under paragraph (4) and section 31 (2), no later than 31 December 2015.

(3) The date of becoming aware shall be

a) the tenth working day after the day when the delivery is attempted if the letter is returned with the marking: "unclaimed",

b) the day when delivery is attempted if the document is returned with the marking: "refused to accept",

c) the thirtieth day following the publication on the website specified under section 16 (3) if it is returned with the marking: "address cannot be identified", "address unknown", "moved out", "delivery obstructed" or "announced as deceased".

(4) If the publication on the website specified under section 16 (3) takes place after 31 December 2015, the complaint pursuant to paragraph (2) may not be submitted later than within sixty days following the publication on the website.

(5) If no complaint is submitted pursuant to paragraphs (1) to (4), the content of the settlement shall be deemed as accepted by the consumer. After it, the settlement may not be contested.

Section 19 (1) If the financial institution has not settled accounts with the consumer and, according to the consumer, the financial institution is subject to settlement obligation pursuant to Act XXXVIII of 2014 or this Act, the consumer may submit a complaint to the financial institution. The complaint may be submitted not later than within sixty days from the publication on the website under section 16 (3); if the consumer is prevented from submitting the complaint, within thirty days from the elimination of the obstacle, but, excluding cases under paragraph (2) and section 31 paragraph (2), no later than 31 December 2015.

(2) If the publication on the website pursuant to section 16 (3) took place after 31 December 2015, the complaint under paragraph (1) may not be submitted later than within sixty days following the publication on the website.

Section 20 (1) To the submission and administration of the complaint under section 18 and 19 shall the provisions of the Hpt. on the administration of complaints and the provisions of the MNB Decree on complaint management shall apply subject to the derogations laid down in section 21 (1) and (1a).

(2) If the person having the right to contest the settlement submits a complaint to the financial institution concerning the settlement which is already subject to a complaint proceeding before the financial institution, the financial institution shall administer the complaints jointly. The time limit for administering the complaint shall commence at the time of receipt of the complaint arriving later.

(3) If the person having the right to contest the settlement submits a complaint to the financial institution regarding a settlement which is already subject to an ongoing action before the Financial Arbitration Board or the court, the financial institution shall inform of it the Financial Arbitration Board or the court no later than within eight days.

(4) In the case specified under paragraph (3), the financial institution shall also inform the Financial Arbitration Board or the court, of

a) it having prepared a new settlement based on the complaint, or

b) having rejected the complaint.

(5) In the case specified under paragraph (4) b), the financial institution shall also inform the Financial Arbitration Board of when its statement was served.

(6) The settlement may not be contested for a reason which has already been decided upon by the Financial Arbitration Board or the court in a final and binding decision.

(7) If the person entitled to contest the settlement submits a complaint for the same reason as was used by someone else as grounds for contesting the settlement concerned, it is sufficient for the financial institution to inform of its former position the person entitled to contest the settlement when providing its position; and if complaint has already been remedied then the financial institution shall provide information of it to the person entitled to contest the settlement, with simultaneously sending him a copy of the new settlement. If the settlement is contested for a reason which has already been decided upon by the court in a final and binding decision, the financial institution shall also provide information thereof.

Section 21 (1) Section 288 (8) of the Hpt. shall not apply; if the complaint is rejected, the consumer, if he maintains the statements included in the complaint, shall initiate the proceedings of the Financial Arbitration Board within thirty days from the delivery of financial institution's statement. If the consumer was prevented from submitting the application, the proceedings shall be initiated within thirty days from the elimination of the obstacle but no later than within six months following the service. The financial institution shall inform the consumer of it in its response and shall provide the mailing address of the Financial Arbitration Board.

(1a) The complaint shall only be submitted in writing and the financial institution shall be obliged to respond within sixty days from its receipt.

(2) Rules of Act CXXXIX of 2013 on the Hungarian National Bank (hereinafter "MNB Act") on the proceedings of the Financial Arbitration Board shall apply subject to the derogations laid down in this Act.

(3) When initiating proceedings at the Financial Arbitration Board, the consumer, in its application, shall also include an explicit request that the Financial Arbitration Board

a) establish that the settlement contains the erroneous data or calculation error referred to by the consumer, establish the right calculation, and order the financial institution to implement that, or

b) establish that the complaint was not late, therefore the rejection of the complaint was not justified, therefore the financial institution is obliged to examine the merits of the complaint in the proceeding for handling complaints and to implement the complaint proceedings in line with the applicable rules, or

c) establish that the financial institution is obliged to make a settlement according to Act XXXVIII of 2014 or this Act and oblige the financial institution to make the settlement.

(4) In the course of the proceedings initiated in the application specified under paragraph (3) *c*), the Financial Arbitration Board may only examine the prevalence of conditions under section 6 (2) and (4) in respect of limitation period.

(5) In the application the following shall be included:

a) in the case specified under paragraph (3) a), the erroneous data or calculation error and the reason therefore,

b) in the case specified under paragraph (3) b), the reason why the complaint was not late,

c) in the case specified under paragraph (3) c), the reason why the financial institution is obliged to make a settlement pursuant to Act XXXVIII of 2014 or this Act,

and the underlying documents shall be attached.

Section 22 (1) The Financial Arbitration Board shall adjudicate the application under section 21 (3) proceeding in a three-member panel, in a written procedure with the proviso that it may hold a hearing if it deems that justified by circumstances. The panel shall decide in a decision in which it approves the settlement agreement or provides for an obligation or shall dismiss the application and terminate the proceedings. The panel shall dismiss the application and terminate the proceedings also if the application is not suitable for the case to be decided upon on the merits.

(1a) In the case specified under section 20 (3), the Financial Arbitration Board shall suspend its proceedings. The duration of the suspension shall not be included in the time limit of the proceeding. The proceedings may be continued, if

a) the financial institution rejects the complaint and within thirty days from serving the statement of the financial institution, the person entitled to contest the settlement does not initiate the proceedings of the Financial Arbitration Board and forty days have elapsed from the service, or

b) the person entitled to contest the settlement initiates the proceedings of the Financial Arbitration Board against the complaint procedure of the financial institution.

(1b) If the Financial Arbitration Board continues its proceedings pursuant to paragraph (1a) b) the Financial Arbitration Board shall adjudicate the applications jointly.

(1c) The Financial Arbitration Board shall terminate its proceedings if the financial institution, by sending the new settlement, announces that it has drawn up a new settlement based on the complaint. The Financial Arbitration Board, in its decision terminating the proceedings, shall inform the applicant of the fact that he has the right to submit a complaint to the financial institution concerning the new settlement.

(2) The proceeding panel shall inform the financial institution of the submission of the application and simultaneously it shall send the copy of the application to the financial institution. In the notice, the proceeding panel shall call upon the financial institution to declare, within fifteen days, in its response as to the legality of the consumer's claim, and send the settlement having been provided for the consumer, together with the underlying data, on an electronic medium in the manner and format specified by the Financial Arbitration Board. The proceeding panel shall also call upon the financial institution to send its response directly to the consumer, and if there is a settlement proposal, it should communicate that by the deadline specified in the notice at the latest. If the parties conclude a settlement agreement, the financial institution shall inform the proceeding panel of this fact and shall send the signed settlement agreement within eight days. After receiving the written settlement agreement, the panel shall approve of it if it complies with legal provisions.

(2a) If the proceeding panel holds a hearing, it shall inform the parties in writing of the hearing date in due time after receiving the response under paragraph (2) but no later than eight days before the hearing.

(3) Neither the applicant, nor the financial service provider may submit an objection of lack of competence regarding the proceedings of the Financial Arbitration Board either in the response or at the hearing.

(4) The decision of the Financial Arbitration Board providing for an obligation shall oblige the financial institution concerned even if it has not made a general or ad hoc submission.

(5) If the person entitled to contest the settlement requests the proceeding of the Financial Arbitration Board in a complaint submitted for the same reason as the one for which someone else has already contested the given settlement and in respect of which

a) the Financial Arbitration Board has made a decision for which no court proceedings was not initiated in due time, or

b) the court has made a decision,

it is sufficient for the Financial Arbitration Board to only refer to this fact when rejecting the complaint.

Section 23 (1) Section 116 (1) of the MNB Act shall not apply; the consumer and the financial institution, after the proceedings of the Financial Arbitration Board, may apply for the setting aside of the decision in a non-contentious proceeding pursuant to sections 24-29.

(2) Section 116 paragraph (2) of the MNB Act shall apply subject to the derogation that, in addition to section 116 (3) of the MNB Act, the consumer and the financial institution shall also have the right to apply for the setting aside of the decision providing for an obligation also for the proceedings' non-compliance with the legal provisions of this Act. No retrial shall be possible.

Section 24 Unless otherwise provided by sections 25 to 29, the rules of Act III of 1952 on civil procedure (hereinafter "Pp.") shall accordingly apply to the non-contentious proceeding subject to the derogations originating from the specificities of the non-contentious civil proceedings.

Section 25 (1) The consumer as a requesting party may initiate a non-contentious civil proceeding against the financial institution that makes the settlement as a requested party within thirty days from the service upon him of the Financial Arbitration Board's decision either terminating the proceedings or establishing the correct settlement on the basis of the complaint under section 21 (3) a)for having the decision terminating the proceeding or establishing the correct settlement set aside. If the consumer is prevented from submitting the request, he shall submit the request within thirty days from the elimination of the obstacle but no later than 31 October 2016.

(2) The requesting party, in its request against the decision rejecting the application or terminating the proceedings, may request that the court in its decision

a) establish that the settlement of the financial institution or the decision of the Financial Arbitration Board is in breach of law, set aside the decision of the Financial Arbitration Board which is in breach of law and oblige the financial institution to make a new settlement,

b) establish that the complaint was not late, therefore the rejection of the complaint was not justified, therefore the financial institution, in a complaint proceedings, is obliged to examine the merits of the complaint and implement the complaint proceedings in line with the applicable rules,

c) establish that the financial institution is obliged to settle accounts with the requesting party pursuant to Act XXXVIII of 2014 or this Act and oblige the requested party to make the settlement or

d) establish that unless the Financial Arbitration Board rejected the consumer's request and terminated the proceedings due to the lack of grounds, the Financial Arbitration Board's decision is in breach of law, set aside the decision and oblige the Financial Arbitration Board to carry out new proceedings.

(3) If the Financial Arbitration Board, in its decision, makes the correct settlement that is not coincides with the consumer's request, the requesting party may ask the court to establish that the Financial Arbitration Board's decision is in breach of law, set aside the decision and oblige the Financial Arbitration Board to carry out new proceedings.

(4) The requesting party, in its request under to paragraph (2) a) or, if the requesting party is the consumer, in its request under paragraph (3), may only ask the court to establish that the Financial Arbitration Board's proceeding is in breach of law with reference to an erroneous data or calculation error which served as grounds for requesting the Financial Arbitration Board's proceedings. If the requesting party is a financial institution, it may only base its request under paragraph (3) on facts which prove that the decision of the Financial Arbitration Board is in breach of law.

(5) The requesting party, in his request specified under paragraph (2) b), may only present reasons as to why the complaint was not late which he also used as grounds to request the proceedings of the Financial Arbitration Board.

(6) The requesting party, in his request specified under paragraph (2) c), may only present reasons as to why the financial institution is subjected to a settlement obligation towards him pursuant to Act XXXVIII of 2014 or this Act, which he also used as grounds to request the proceedings of the Financial Arbitration Board.

(7) The requesting party, in his request specified under paragraph (2) d), may only present a reason as to why the rejection of the complaint was not justified which also demonstrate that the decision made by the Financial Arbitration Board is in breach of law.

Section 26 (1) The financial institution making the settlement as a requesting party may initiate a non-contentious civil proceeding for amending the Financial Arbitration Board's decision against the consumer as a requested party within thirty days from delivery of the decision of the Financial Arbitration Board to the requesting party.

(2) The requesting party, in his request, may ask the court to amend the decision of the Financial Arbitration Board and to establish in its decision that

a) the settlement is correct or

b) the complaint is late, therefore the complaint proceedings are not to be executed, or

c) the requesting party is not obliged to settle accounts with the requested party pursuant to Act XXXVIII of 2014 or this Act.

(3) The requesting party, in his request, may only present reasons to substantiate his request which he has also presented in the proceedings of the Financial Arbitration Board.

Section 27 (1) The non-contentious civil proceeding shall fall under the territorial jurisdiction of the district court operating at the seat of the regional court having its territorial jurisdiction where the consumer has his domicile, and on the territory covered by the territorial jurisdiction of the Budapest-Capital Regional Court, the Pest Central District Court shall have territorial competence. In absence of domicile in Hungary, territorial jurisdiction shall be based on the residence of the consumer; if the residence of the consumer is unknown or is located abroad, the last domestic residence shall be taken into account; if this cannot be established or the consumer has never had a domestic residence, the territorial jurisdiction shall be based on the seat of the financial institution. The non-contentious proceedings under paragraph (3) d) shall be carried out by the court where the suspended proceeding is pending.

(2) The request shall be submitted to the Financial Arbitration Board. The Financial Arbitration Board shall forward the request together with the documents of the case to the court within eight days from the receipt thereof. The requesting party and the requested party shall submit the request on a form, if such a form exists pursuant to law.

(3) In the case specified under section 20 (3), the court shall suspend its proceedings. The suspended proceedings shall be continued if

a) the financial institution rejects the complaint and within thirty days from serving the statement of the financial institution, the person entitled to contest the settlement does not initiate the proceedings of the Financial Arbitration Board,

b) the Financial Arbitration Board announces that the parties, including the requesting party, have made a settlement agreement,

c) the person entitled to contest the settlement initiates the proceedings of the Financial Arbitration Board against the complaint procedure of the financial institution and the requesting party did not initiate non-contentious civil proceedings within thirty days against the Financial Arbitration Board's decision on rejecting the request and terminating the proceeding, or

d) the person entitled to contest the settlement initiated the proceedings of the Financial Arbitration Board against the complaint procedure of the financial institution and the requesting party requested non-contentious civil proceedings against the Financial Arbitration Board's decision rejecting the request and terminating the proceedings.

(4) Section 155 of the Pp. shall apply to the suspension of the proceedings with the proviso that the court decision ordering suspension may not be appealed.

(5) The court shall terminate the suspended proceedings if the Financial Arbitration Board has established the correct settlement and obliged the financial institution to implement it and the financial institution did not initiate non-contentious civil proceedings against the decision of the Financial Arbitration Board. The court, in its order terminating the proceedings, shall inform the requesting party that he has the right to submit a complaint to the financial institution in respect of the new settlement.

(6) If the court is obliged to continue the suspended proceedings pursuant to paragraph (3) d), the court shall join the requests.

Section 28 (1) In the non-contentious civil proceeding, the court shall decide exclusively on the basis of the documents and data which were available during the proceeding of the Financial Arbitration Board. No other evidence may be taken in the proceedings.

(2) Junior judges may proceed in the first instance independently, with a right to sign independently and may take decisions on the merits of cases in non-contentious civil proceedings.

(3) The court may hear the parties, if it is necessary for making a decision.

(4) In the non-contentious civil proceedings no stay or suspension shall be possible.

(5) In the out of court civil proceedings no review and retrial shall be possible.

(6) The submission of the request shall have a suspensory effect on the enforcement of the decision made by the Financial Arbitration Board.

(7) Regarding cases under section 22 (5), it is sufficient for the court to examine whether the grounds on which the requesting party initiates the court proceedings upon a complaint that have already served as the basis for someone else to contest the given settlement and which have already been adjudicated by the Financial Arbitration Board or the court in a final decision.

Section 29 The final and binding decision made by the Financial Arbitration Board in its proceedings and in the non-contentious proceedings under section 23 (1) in respect of the settlement may not be contested in any other civil proceeding.

12. The settlement, its communication and review if a claim manager is involved

Section 30 (1) If the settlement is made pursuant to section 7, the review of the financial institution subject to the settlement obligation and the review of the settlement made by the claim manager may be requested separately as specified under sections 18-29.

(2) The settlement obligation under section 7 (2) shall not be affected by the consumer contesting the settlement prepared by the financial institution subject to the settlement obligation.

(3) If the settlement of the financial institution subject to the settlement obligation is amended as a result of the enforcement of claims pursuant to sections 18 to 29, the consumer may request that the claim manager amend the settlement, taking into account the new settlement prepared by the financial institution subject to settlement obligation. Review of the amended settlement may be enforced as specified in sections 18-29.

13. Certain rules on settlements with the heir

Section 31 (1) If the consumer is replaced by an heir, the rules of succession shall apply to the claim.

(2) In the case of probate proceedings and supplementary probate proceedings, the time limit commencing upon the elimination of the obstacle specified under section 18 (2) and section 19 (1) shall be calculated from the completion of the probate proceedings or supplementary probate proceedings, or if the launching of the probate proceedings, supplementary proceedings or the fact that they have already been in progress is reported to the financial institution within thirty days following the publication pursuant to section 16 (3) in a way that can be evidenced. If the probate proceedings or supplementary probate proceedings are completed after 31 December 2015, the complaint under section 18 (2) and or section 19 (1) shall be submitted no later than within sixty days from the completion of the probate proceedings or supplementary probate proceedings.

14. Audit procedure

Section 32 (1) The Supervising Authority shall check in the course of an audit procedure, specified in the MNB Act, that may be launched ex officio whether the financial institutions have complied with the legal provisions of Act XXXVIII of 2014, this Act and the MNB Decree.

(1a) The basis of the audit procedure of the Supervising Authority shall be, in particular the practice of the financial institution affecting a large number of consumers which, by not recognising the consumer contract nature of the loan contract or the financial lease contract, by qualifying them differently or by expressing a different standpoint regarding their character, aims to avoid the settlement obligation and prevent the submission of settlement requests.

(2) The obligations imposed upon financial institutions in respect of their conduct towards consumers specified in Act XXXVIII of 2014, this Act and the MNB Decree shall be considered as provisions for consumer protection pursuant to sections 81-89/B of the MNB Act.

15. Proceedings launched by actions in the public interest

Section 32/A (1) The financial institution shall be obliged to submit to the Supervising Authority, within thirty days after the entry into force of this provision, with the exception included in paragraph (2) in the manner specified in paragraphs (3)-(8),the list of contract clauses included in General Terms and Conditions under section 6 (2) of Act XXXVIII of 2014 (hereinafter "the extract of the financial institution"), which provides for the possibility of a unilateral increase of the interest, cost or fee.

(2) The financial institution is exempted from the obligation specified under paragraph (1) in respect of the types of financial services it provides in respect of which there was no amendment of contract after 26 November 2010 resulting in a unilateral increase of interest, fee or cost. In this case, the financial institution shall be obliged to enlist these types of its services, with the clear indication of the respective General Terms and Conditions, in its separate declaration and submit the declaration to the Supervising Authority by the deadline specified in paragraph (1).

(3) The extract of the financial institution shall be submitted on the form provided by the Supervising Authority for this purpose, including the data specified in Annex 1. The Supervising Authority may provide various types of forms, and legends and instructions to help filling in the form, which are published on its internet website. The date of publication of the forms shall be indicated on the website. From the date of publication, using the regular forms, list of codes, legend and instructions based on this paragraph shall be mandatory. The form shall be designed to provide enough space for the declaration. If the form does not comply with legal provisions, the Supervising Authority shall promptly modify it or provide a new form. After the publication of the new or modified form, the Supervising Authority shall indicate on its website that the form is new or has been modified.

(4) In the extract of the financial institution, the clauses shall be presented in a breakdown according to types of services and the text in force on different dates indicating the period of application in a way which makes it possible for the clauses to be clearly identified according to the date of application at different levels of regulation applicable simultaneously and in conjunction.

(5) In the course of preparing the financial institution's extract, a new application period shall start if any amendment takes place in any document at any level of regulation, that is if a new document or a new provision enters into force or is applicable at any level of regulations irrespective of the fact whether the change has affected parts containing clauses providing for the possibility of unilaterally increasing the interest, cost or fee.

(6) For an interest tied to a reference, the change of the interest originating from the change in the reference interest rate shall not qualify as unilateral increase of the interest rate.

(7) In the information sheet attached to the financial institution's extract, the system, structure and levels of regulation and their relationship shall be described.

(8) The financial institution's extract and the information sheet under paragraph (7) shall also be submitted in an editable electronic format, bearing qualified electronic signature,

a) in an electronic mail and

b) on an electronic medium.

Section 32/B (1) If the financial institution, until the date specified in section 32/A (1), has undertaken an obligation, in an explicit and irrevocable declaration containing no conditions drawn in a notarial deed and submitted to the Supervising Authority, to make a settlement in respect of

a) all the consumer loan contracts pursuant to Act XXXVIII of 2014 section 6 (2) or

b) consumer loan contracts specified in section 6 (2) of Act XXXVIII of 2014 specified according to the type of financial services

as regards overpayments originating from increased interest rate, cost or fees due to the unilateral amendment of the contract, in favour of its clients considered as consumers, pursuant to the provisions of this Act, the financial institution shall be exempted from the obligation specified under section 32/A (1) pertaining to the consumer loan contracts falling under the scope of the declaration.

(2) The submission of the declaration referred to in paragraph (1) to the Supervising Authority gives rise to an obligation for the financial institution to settle accounts with consumers concerned pursuant to this Act within the time limit specified in section 13 (2). The settlement may be reviewed also pursuant to the provisions of this Act.

(3) In respect of including the declaration specified in paragraph (1) in a public deed, section 30/I of the Decree of the Minister of Justice No. 14/1991 (XI. 26.) IM on the fees of notaries public shall apply.

(4) If the scope of the declaration under paragraph (1) extends only to part of the consumer loan contracts on certain types of financial services, specified under section 6 (2) of Act XXXVIII of 2014, the financial institution, in the declaration under paragraph (1) shall indicate the types of financial services concerned, with a clear indication of General Terms and Conditions relating thereto, the identification number of the contracts concerned and the amount of outstanding claims on the date when the declaration is made based on individual contracts concerned.

(5) Concurrently with making the declaration under paragraph (1), the financial institution shall publish on its website a notice that is in line with the content of the declaration submitted to the Supervising Authority entitled "Information pertaining to settlements and HUF conversion". The notice shall include a clause according to which the financial institution settles the unilateral interest, cost and fee increases pursuant to the provisions of this Act.

(6) The Supervising Authority may not bring an action in the public interest in respect of the contract clauses of the types of financial services which fall under the scope of the declaration of the financial institution as specified in paragraph (1).

(7) The financial institution may make the declaration under paragraph (1) following the fulfilment its obligation set out in section 32/A paragraph (1) until the legal effects arise, upon the communication of the statement of claim to him, of the commencement of a legal action by the Supervising Authority pursuant to section 6 (2) of Act XXXVIII of 2014.

Section 32/C With a view to check compliance with obligations under sections 32/A and 32/B, an audit proceeding of consumer protection may also be initiated ex officio pursuant to subtitle 29 of chapter VII of the MNB Act.

Section 33 (1) The proceeding brought by an action in the public interest pursuant to section 6 (2) of Act XXXVIII of 2014 shall fall under the exclusive jurisdiction of the Budapest-Capital Regional Court.

(2) The proceeding initiated by an action in the public interest shall be governed by provisions in subtitle 6 of Act XXXVIII of 2014 subject to the derogations laid down in sections 34-36/D.

Section 34 (1) If the statement of claim of the Supervising Authority was received before 14 February 2015, it shall not be rejected on this ground, but shall be considered as if the statement of claim had been submitted on 14 February 2015.

(2) The court shall examine the statement of claim within fifteen days of receipt and shall decide upon whether to dismiss the statement of claim or set the date of a hearing. The date of the hearing shall be set no later than on the fifteenth day from the examination of the statement of claim. The date of the hearing shall be set to allow for the statement of claim to be served on the defendant at least eight days before the hearing. The court shall adjudicate the statement of claim within forty-five days, which period shall start upon setting the hearing date.

(3) Section 7 (2), Section 8 (1) and Section 13 (6) of Act XXXVIII of 2014 shall not apply in the action.

(4) The personal exemption from duties of the Supervising Authority shall also apply to this procedure.

Section 35 (1) Instead of the provisions of section 8 (3) to (5) of Act XXXVIII of 2014 the provisions laid down in this section shall be applied.

(2) The Supervising Authority shall request the establishment of the invalidity of all the clauses in the General Terms and Conditions of a financial institution under section 6 (2) of Act XXXVIII of 2014 in the same statement of claim.

(3) The Supervising Authority may only request the establishment of what is set out in section 36 (2).

(4) Section 121 (2) of the Pp. shall not be applied in the action. In addition to what is defined in section 121 (3) of the Pp., the extract of the General Terms and Conditions, specified in paragraph (2), drawn up in the same deed shall also be attached to the statement of claim, containing such clauses only in respect of which the Supervising Authority requests the establishment of invalidity; for contract clauses the period for which the financial institution applied them shall also be indicated. In the extract, in addition to individual contract terms, the legal basis which, according to the Supervising Authority, substantiate the statement of claim shall also be indicated. Furthermore, the statement of claim shall be accompanied by the deed or its copy (extract), which is necessary to certify other circumstances to be taken into account ex officio, except if the data can also be proved by presenting an identity card; this should be referred to in the statement of claim.

(5) An electronic medium shall be attached to the statement of claim, which contains the statement of claim and its attachments in an editable format, edited by means of an IT tool.

Section 35/A Section 13 (4) of Act XXXVIII of 2014 shall apply subject to the derogation that the court adjudicates the appeal within forty-five days from the starting date specified in section 13 (4) of Act XXXVIII of 2014.

Section 36 (1) Instead of section 11 of Act XXXVIII of 2014, the provisions contained in this section shall be applicable.

(2) The court in the proceedings shall only examine whether the contract clause having been considered unfair by the Supervising Authority complies with the criteria of fairness specified in section 4 (1) of Act XXXVIII of 2014.

(3) If the court establishes that the contract clause having been considered unfair by the Supervising Authority complies with all the conditions specified in section 4 (1) of Act XXXVIII of 2014 and therefore the contract clause is fair, it shall dismiss the claim.

(4) If the court establishes that the contract clause having been considered unfair by the Supervising Authority does not comply with any of the conditions specified in section 4 (1) of Act XXXVIII of 2014 and therefore it is unfair, it shall establish that the contract clause is unfair and therefore invalid.

Section 36/A (1) If the Supervising Authority, in the course of its proceedings initiated pursuant to the MNB Act until 31 December 2016, establishes that any of the declarations made by the financial institution pursuant to section 32/A is incomplete or does not comply with reality in any respect, it shall call upon the financial institution, setting a short deadline, to submit its complete declaration concerning the financial service to the Supervising Authority, in compliance with the provisions of this Act.

(2) The Supervising Authority shall terminate its proceedings pursuant to paragraph (1) in respect of the remedy of deficiencies of declarations under section 32/A by issuing an order (hereinafter "order terminating the remedy of deficiencies proceedings"), if the financial institution fully complies with the notice. The service of the order of the Supervising Authority terminating the proceedings to remedy the deficiencies shall be governed by the rules of the Supervising Authority on service of documents by own employee as specified in the MNB Act, disregarding postal service.

(3) If the Supervising Authority did not file an action in the public interest until 30 April 2015 against the financial institution, but the data arising in its proceedings pursuant to (1) give grounds for it, action in the public interest may be brought pursuant to section 6 (2) of Act XXXVIII of 2014 within sixty days from the date when the order terminating the proceedings for the remedy of deficiencies becomes final and binding.

Section 36/B (1) If, at the time when the notice to remedy the deficiencies pursuant to section 36/A paragraph (1) was issued, there is a civil proceeding in progress filed against the financial institution pursuant to section 6 (2) of Act XXXVIII of 2014 by the Supervising Authority, the Supervising Authority, in this judicial proceedings, may enforce its claim founded on the data having arisen in the proceedings pursuant to section 36/A (1).

(2) The Supervising Authority shall immediately inform the proceeding court of its issuing the notice to remedy deficiencies pursuant to section 36/A (1), and shall also enclose

the notice issued by it to remedy the deficiencies. Upon this notice the court shall suspend the proceeding until the order terminating the proceeding for the remedy of deficiencies becomes final; the court decision suspending the proceedings may not be appealed.

(3) If the court suspends the proceedings of first instance in line with paragraph (2), the Supervising Authority, within eight days from the date when the order terminating the proceedings to remedy the deficiencies become final, shall request the continuation of the proceedings from the court, simultaneously it may submit its request concerning changes in the statement of claim if it is founded by the data arisen in its proceedings pursuant to section 36/A (1).

(4) If the financial institution in its capacity as the defendant announces itself in the civil proceedings initiated by the Supervising Authority pursuant to section 6 (2) of Act XXXVIII of 2014 that any of its declarations pursuant to section 32/A is deficient due to the provision of erroneous data or that the declaration does not comply with the facts in any part, simultaneously with the announcement it shall attach the declaration relating to the financial service indicated in two copies, in compliance with the provisions of this Act.

(5) The Supervising Authority may amend its statement of claim submitted pursuant to section 6 (2) of Act XXXVIII of 2014 within eight days after the order terminating the proceeding to remedy the deficiencies becomes final; within a maximum of eight days as specified by the court if the defendant makes an announcement as set out in paragraph (4), but in neither cases later than the closure of the hearing preceding the hearing where the decision of first instance is made. The application for the amendment of the statement of claim shall be accompanied by the extract of the General Terms and Conditions affected by the amendment of the statement of claim, included in a public deed and containing the legal justification for the amendment of the statement of claim.

(6) If the statement of claim is amended under paragraph (3) or the announcement is made by the defendant pursuant to paragraph (4), The hearing may be postponed repeatedly, if necessary,. The court shall adjudicate the statement of claim within a further maximum forty-five days from the submission of the request to amend the claim in cases falling under paragraph (3) and within a further maximum forty-five days from the submission of the announcement pursuant to paragraph (4).

Section 36/C (1) If the suspension of the hearing in the action pursuant to section 36/B (2) or the announcement made by the defendant pursuant to section 36/B (4) take place in the civil proceedings of second instance, the Supervising Authority may submit its declaration on the necessity of the amendment of the statement of claim within eight days from the date when the order terminating the proceedings to remedy the deficiencies becomes final, in the case of the announcement of the defendant pursuant to section 36/B (4) within maximum eight days specified by the court, but in neither cases later than the closure of the appeal hearing. The announcement concerning the necessity to amend the statement of claim shall be accompanied by the extract of the General Terms and Conditions affected by the amendment of the statement of claim included in a public deed, indicating the legal justification for the necessity to amend the statement of claim.

(2) In cases specified under paragraph (1), the hearing may be repeatedly postponed as necessary with the proviso that, for the announcement of the Supervising Authority concerning the necessity to amend the statement of claim, based on a proceeding to remedy the deficiencies, the court shall make the decision of second instance within a further maximum forty-five days from the submission of the request to amend the claim or from the submission of the announcement by the defendant pursuant to paragraph (4).

(3) The court of second instance, based on the available data, shall set aside the judgment of the court of first instance, irrespective of the limitations of the review application and the review counter-application, in part or in full, and shall order the court to hold a new hearing and take a new decision, if repeating or complementing the hearing is necessary in part or in full due to the possibility to amend the statement of claim. The court of second instance shall decide upon the merits of those parts of the first instance judgment which were not set aside.

Section 36/D (1) If, at the time of issuing the notice to remedy the deficiencies pursuant to section 36/A (1), the civil proceedings launched against the financial institution by the Supervising Authority pursuant to section 6 (2) of Act XXXVIII of 2014 have been terminated with a final decision, but, based on the data having arisen in the proceedings pursuant to section 36/A (1), the amendment of the statement of claim would be justified, the Supervising Authority may submit an application for retrial to the court of first instance having been proceeded in the case within sixty days from the time when the order terminating the proceeding to remedy the deficiencies becomes final.

(2) In the proceedings initiated by an application for retrial specified under paragraph (1) (hereinafter "retrial"), the provisions of this Act on proceedings initiated by actions in the public interest and the provisions of the Pp. on retrial shall apply subject to derogations laid down in paragraphs (3) to (5).

(3) Where this Act or Act XXXVIII of 2014 refers to the statement of claim or a claim, they shall be interpreted as application for retrial in the retrial proceedings.

(4) In the retrial proceeding

a) section 35 (2) and (4),

b) section 7 (7) b) and k) of Act XXXVIII of 2014, and

c) section 121 (2), sections 260, 261, 264, 266, 266/A and 267 of the Pp.

shall not apply.

(5) In addition to what is defined in section 121 (3) of the Pp., the extract of the General Terms and Conditions pursuant to section 6 (2) of Act XXXVIII of 2014 drawn up in one public deed shall also be attached to the application for retrial, which contains only such clauses in respect of which the Supervising Authority requests the establishment of invalidity; regarding contract clauses the period for which the financial institution applied them shall also be indicated. In addition to individual contract terms, the legal basis which, according to the Supervising Authority give ground for the application for retrial shall also be indicated in the extract. Furthermore, the application for retrial shall also be accompanied by the public deed or its copy (extract), required to certify other circumstances to be taken into account ex officio, except if the data can also be proved by presenting an identity card, this should be referred to in the application for retrial.

(6) An electronic medium shall be attached to the application for retrial which includes the application for retrial and its attachments in an editable format, edited by means of an IT tool.

(7) The retrial shall be held within the limitations of the application for retrial.

Section 36/E Depending on the outcome of civil proceedings pursuant to sections 36/A-36/D, the settlement pursuant to this Act shall be sent by the financial institution to the consumer in the period specified in section 13 (2). If the civil proceedings initiated by the Supervising Authority is terminated after 1 August 2015, the final deadline for sending out the settlement relating to the consumer loan contracts concerned shall be the sixtieth day from the final termination of the civil proceedings. If, based on the outcome of proceedings pursuant to sections 36/A-36/D, the settlement made earlier pursuant to this Act needs to be amended, the final deadline for sending out the new settlement in respect of the consumer loan contracts concerned shall also be the sixtieth day following the termination of the civil proceeding with a final decision.

16. Excluding the application of the rule on actions aiming to establish the invalidity of the contract or certain contractual provisions (partial invalidity)

Section 37 (1) In respect of contracts falling under the scope of this Act, the party may request the establishment of the invalidity of the contract or the invalidity of certain contractual provisions (hereinafter "partial invalidity") from the court, irrespective of the reason for invalidity, regarding the application of the legal consequences of invalidity, that is to declare the contract valid or effective until the date when the decision is made. Failing that, the statement of claim and the merits of the claim, following an unsuccessful notice to remedy the deficiencies, may not be adjudicated. If the party requests the legal consequence of invalidity or partial invalidity to be deducted, he shall also indicate the legal consequences the court is to apply. As regards the application of the legal consequence, the party shall also submit an explicit claim covering the settlement between the parties and indicated as an amount.

(2) Given the provisions of paragraph (1) in respect of contracts covered by the Act, pursuant to section 239/A (1) of Act IV of 1959 on the Civil Code and section 6:108 (2) of Act V of 2013 on Civil Proceedings, if their conditions stipulated in this Act are met, the statement of claim for the invalidity or partial invalidity of the contract shall be dismissed without issuing summons or the proceedings shall be terminated. The dismissal of the statement of claim without summons or the termination of the proceedings shall not apply, if the party also submitted a statement of claim in the proceedings other than the statement of claim for the establishment of the invalidity or partial invalidity of the contract; in this case the statement of claim for the establishment of invalidity shall be considered as not maintained by the party. The same shall apply to proceedings pursued after the termination of suspension.

(3) If, in the proceedings in progress the dismissal of the statement of claim without summons shall not apply, the proceedings shall be terminated if the party in its claim (counterclaim) within thirty days from the service of the court's notice to remedy the deficiencies fails to request the deduction of the legal consequence of invalidity or partial invalidity of the contract, furthermore, if the party fails to indicate the legal consequence he requests to apply. The proceedings may not be terminated if the party also submitted a statement of claim in the proceedings other than the statement of claim for the establishment of the invalidity or partial invalidity of the contract; in this case the statement of claim for the establishment of invalidity shall be considered as not maintained by the party.

Section 37/A. (1) In the course of deducting the legal consequences of invalidity, the court shall establish the payment obligations of the parties, basing such decision on the data in the revised settlement pursuant to section 38 (6), applying the rules on settlement laid down in this Act.

(2) After the effective date of settlement, the repayments effected up to the date when the decision is made shall be credited to the consumer pursuant to applicable rules.

17. Rules on suspended actions

Section 38 (1) In proceedings suspended pursuant to

a) section 16 (1) of Act XXXVIII of 2014 until a measure is taken as specified in a separate Act, but no later than 31 December 2014,

b) section 16 (2) of Act XXXVIII of 2014 until a measure is taken as specified in a separate Act, but no later than 31 December 2015

the proceedings shall be continued following the thirtieth day after the announcement of the revised settlement made between the financial institution and the consumer, with the exception of the case specified in paragraph (5). The announcement shall be made by the counterparty of the consumer. If the consumer is the plaintiff and the statement of claim has not been served on his counterparty yet, the notification obligation shall be on the consumer.

(2) If the proceeding may not be continued until 31 December 2014 pursuant to paragraph (1) a), the duration of suspension shall be extended by virtue of this Act until the revised settlement is notified.

(3) If the proceeding may not be continued until 31 December 2015 pursuant to paragraph (1) b), the duration of suspension shall be extended by virtue of this Act until the revised settlement is notified.

(4) In the case specified in paragraphs (2) and (3), the parties shall not be notified of the extension of the suspension, the proceedings shall be continued after the thirtieth day following the notification of the revised settlement made between the financial institution and the consumer, with the exception of the case specified in paragraph (5). The notification shall be made by the counterparty of the consumer. If the consumer is the plaintiff and the statement of claim has not been served on his counterparty yet, the notification obligation shall be on the consumer.

(5) If, in respect of the consumer loan contract subjected to the suspended proceedings pursued pursuant to paragraphs (1) and (4), an enforcement proceeding was also initiated, and this enforcement proceeding is initiated in accordance with sections 41 and 42 at a date earlier than the date indicated in paragraph (1) or (4), the proceedings shall be continued after the thirtieth day following the announcement of the fact that the enforcement proceedings are carried out. The continuation of the enforcement proceedings shall be announced by the consumer's counterparty while the consumer may announce it. If the consumer is the plaintiff and the statement of claim has not been served on his counterparty yet, the notification obligation shall be on the consumer.

(5a) If the claim originating from the consumer loan contract subjected to the suspended proceedings to be continued pursuant to paragraphs (1) and (4) is secured by a pledged item, which, until the date indicated in section 43 cannot be sold outside judicial enforcement and this circumstance occurs earlier than the dates referred to in paragraph (1) /or (4), the suspended proceedings shall be continued after the thirtieth day following the announcement of the termination of the ban on sale. The termination of the ban on sale shall be announced by the counterparty of the consumer, while the consumer may announce it. If the consumer is the plaintiff and the statement of claim has not been served on his counterparty yet, the notification obligation shall be on the consumer.

(6) The settlement shall be considered as revised, if

a) the consumer did not submit a complaint against the settlement to the financial institution within the time limit specified in this Act, or did not submit a complaint on grounds that the financial institution failed to settle accounts with him,

b*)* within the time limit specified in this Act, the consumer did not initiate the proceedings of the Financial Arbitration Board,

c*)* within the time limit specified in this Act, the consumer or the financial institution did not initiate non-contentious proceedings pursuant to section 23 (1) or the court proceeding pursuant to section 23 (2),

d) the decision terminating the non-contentious proceedings initiated by the consumer or the financial institution pursuant to section 23 (1) or the court proceedings pursuant to section 23 (2) has become final and binding.

Section 39 If, in the proceedings suspended pursuant to section 16 of Act XXXVIII of 2014, an action for establishing the invalidity or partial invalidity of the contract is enforced, the statement of claim shall be dismissed without issuing summons, or if the dismissal of the statement of claim without the issue of a summons is no longer possible, the proceedings shall be terminated if the party in its statement of claim (counterclaim) within thirty days from the information provided on the continuation of the proceedings and the service of the notice to remedy the deficiencies does not request the application of the legal consequence of the invalidity or partial invalidity of the contract as set out in section 37 (1). The proceedings may not be terminated if the party also submitted a statement of claim in the proceedings other than the statement of claim for the establishment of the invalidity or partial invalidity of the contract; in this case the statement of claim for the establishment of invalidity shall be considered as not maintained by the party.

Section 40 (1) If the parties to the action, with the exception of the proceedings pursuant to section 39, on the first day of the hearing after the termination of the suspension of the proceedings

a) conclude a settlement agreement,

b) request jointly that the action be terminated,

the court fees shall be borne by the State, beyond that each party shall bear his own costs, and the court shall decide upon these questions ex officio.

(2) The court fee shall also be borne by the State, with the exception of the proceedings under section 39,if the plaintiff, no later than on the first day of the hearing after the termination of the suspension of the proceeding, withdraws its claim which results in the termination of the proceedings. In this case, section 160(1) of the Pp. shall apply subject to the derogation that the plaintiff shall also have the right to withdraw without the consent of the defendant following the commencement of the substantive hearing, and each party shall bear his own costs.

(3) In the case of the termination of the proceedings pursuant to section 39, the court fees shall be borne by the State, beyond that each party shall cover his own costs.

(4) Section 80 (1) of Act XCIII of 1990 on duties shall also apply in the case specified in paragraphs (1) to (3), namely the imposed but still unpaid duty shall be cancelled or the paid fees shall be refunded ex officio.

18. Rules concerning enforcement procedures

Section 41 (1) Rules set out in section 17 of Act XXXVIII of 2014 shall not be applied after the thirtieth day following the notification of the fact that the settlement between the financial institution and the consumer was sent to the debtor, or following the notification referred to in paragraphs (3) or (4).

(2) The party requesting enforcement shall send the notification specified in paragraph (1) to the bailiff, or if the enforceable deed has not been sent to the bailiff, the notification shall be sent to the court, public notary ordering the enforcement, within thirty days following the sending of the settlement to the debtor, attaching the settlement thereto, and simultaneously shall take the measures the party requesting enforcement is obliged to take pursuant to Act LIII of 1994 on judicial enforcement.

(3) By applying the rules laid down in paragraph (2), it shall also be notified if, pursuant to the provisions of this Act, no settlement is to be made in respect of the consumer loan contract.

(4) If the party requesting the enforcement is a claim manager and the consumer did not request from him the settlement pursuant to section 7 (2) within thirty days after the publication on the website specified in section 16 (3), this fact shall be notified in line with rules contained in paragraph (2).

(5) Section 16 (3) of the Decree of the Minister of Justice 14/1994 (IX. 8.) IM on the charges of judicial enforcement shall not be applied in cases specified in paragraph (1).

(6) The bailiff shall commence the administration of cases registered as suspended pursuant to section 17 of Act XXXVIII of 2014 within sixty days of receipt of the notification specified in paragraph (2) and its enclosures.

(7) If, pursuant to paragraph (1), the rules laid down in section 17 of Act XXXVIII of 2014 shall no longer apply in enforcement proceedings regulated in section 17 of Act XXXVIII of 2014, and earlier in the proceedings the debtor was granted the option to repay in instalments, the debtor shall repay the instalments at regular intervals as specified by the rules on the permission for paying in instalments if the debtor requested the application of section 17 (3) of Act XXXVIII of 2014 in line with section 17 (9) of Act XXXVIII of 2014.

(8) If, pursuant to paragraph (1) the rules laid down in section 17 of Act XXXVIII of 2014 shall no longer apply in enforcement proceedings regulated in section 17 of Act XXXVIII of 2014, and earlier in the proceedings garnishment was effected against the debtor, if the debtor requested the application of section 17 (3) of Act XXXVIII of 2014 in line with section 17 (9) of Act XXXVIII of 2014,the necessary measures shall be taken to continue the garnishment.

(9) If the enforceable document was not issued yet when the notification specified in paragraph (1) was received by the court or public notary ordering the enforcement, and as a result of the settlement the claim of the party requesting the enforcement differs from the request for the issue of the enforceable public deed that has been already submitted, the party requesting the enforcement shall present the request for the issue of the enforceable deed as amended according to the result of the settlement and shall also present the settlement, according to the rules concerning the request for the issue of the enforceable deed and in sufficient number of copies; or if the claim is no longer effective as a result of the settlement, he shall be obliged to withdraw the request for the issue of an enforceable public deed having already been submitted. Failing that, the court, public notary ordering the enforcement shall dismiss the request for the issue of the enforceable public deed. If the enforceable public deed has already been issued but it has not yet been sent to the bailiff, the court, the public notary ordering the enforcement shall send to the bailiff the settlement submitted by the party requesting the enforcement as an annex to the enforceable public deed.

(10) If the enforcement case was submitted to the court, the bailiff shall inform the court of the notification under paragraph (1).

(11) In enforcement proceedings regulated in section 17 of Act XXXVIII of 2014, the rules set out in section 17 of Act XXXVIII of 2014 shall not apply after 31 December 2016, with the proviso that if up to this point in time the party requesting the enforcement does not make the notification pursuant to paragraphs (2) to (4), the enforcement, with the exception laid down in this paragraph, shall be stay pursuant to section 52 c) of Act LIII of 1994 on judicial enforcement (hereinafter "Vht."). If repayment in instalments has been granted for the debtor, or the employer (organ disbursing the remuneration) confirmed garnishment and there is no opportunity for any other action or no other action is necessary, the procedural actions and measures may be taken with a view to a payment in instalments or garnishment.

(12) If, on sending the notification specified in paragraph (1), the enforcement has already been ordered, the fee for the bailiff shall be adjusted to the sum to be enforced, including the principal, the contribution and costs if the value of the enforcement case established in this manner is lower

than the sum indicated in the enforceable public deed, including the principal, the contribution and costs. For the purposes of this paragraph, the case shall qualify as settlement when the party requesting the enforcement owes to the consumer and the party requesting enforcement is obliged to pay that amount to the consumer pursuant to section 17 (1), and the party requesting enforcement includes this claim of the consumer in the claim affected by the enforcement; if the party requesting enforcement makes a declaration to this effect.

(13) For calculating the amount of the commission for collection, the amount by which the party requesting the enforcement reduced the claim to be enforced by means of the settlement specified in paragraph (12) may not be considered as amount collected.

(14) If the party requesting enforcement reduced the claim to be enforced by means of the settlement specified in paragraph (12), in respect of the amount by which the enforceable claim was reduced, the bailiff shall not be entitled to the amount payable to him for executing the enforcement pursuant to section 34 (5) of the Vht.

Section 42 (1) The vacating of the residential property defined in section 303 of the Vht., taking into account the provisions laid down in section 182/A of the Vht.,may be executed on the thirtieth day following the notification of the bailiff of the fact that the settlement between the financial institution and the consumer was sent to the debtor or, on the thirtieth day following the notification specified in paragraph (2) or (3), the notification shall be governed by the rules under section 41 paragraph (2).

(2) Applying the rules laid down in section 41 (2), it shall also be notified if, pursuant to the provisions of this Act, no settlement is required to be made in respect of the consumer loan contract.

(3) If the party requesting the enforcement is a claim manager and the consumer did not request from him the settlement pursuant to section 7 (2) within thirty days after the publication on the website specified in section 16 (3), this fact shall be notified by applying the rules laid down in section 41 (2).

(4) The execution of the vacation of the residential property specified in section 303 of the Vht., with respect to the provisions under section 182/A of the Vht., shall be implemented after 31 December 2016 at the latest.

Section 42/A In respect of enforcement proceedings based on claims originating from consumer loan contracts secured by mortgage lien, if the conditions specified in section 41 and section 42 are met on 15 September 2015 or earlier than that, the time limits specified in sections 41 and 42 shall commence on 16 September 2015.

(2) If, in the course of enforcement, a residential property with a market value of less than sixty million forints was also seized, no action can be taken with a view to the sale of the property on the basis of which the buyers may make a valid bid. In these cases, actions with a view to the sale of the residential property may only be taken if the party requesting the enforcement and the debtor jointly request the sale of the residential property pursuant to section 157 of the Vht. after 15 September 2015, in the absence of such a request only if the time limit specified in section 104 (5) and (6) of Act CV of 2015 on the debt settlement of natural persons have already expired and the debtor, the co-debtor, surety or owner of the pledged item did not submit their request to initiate the proceeding with a view to debt settlement.

19. The application of the rules of the government decree regulating the sale of pledged items outside judicial enforcement

Section 43 (1) In the proceeding regulated under section 18 of Act XXXVIII of 2014, the rules laid down in section 18 of Act XXXVIII of 2014 shall not be applied after the thirtieth day after the settlement made between the financial institution and the consumer is sent to the debtor.

(2) In the proceeding regulated under section 18 of Act XXXVIII of 2014, the rules pursuant laid down in section 18 of Act XXXVIII of 2014 shall not be applied after the thirtieth day following the establishment of the fact that in respect of the consumer loan contract no settlement is to be made pursuant to this Act.

(3) In the proceeding regulated under section 18 of Act XXXVIII of 2014, the rules in section 18 of Act XXXVIII of 2014 shall not be applied after the thirtieth day following the establishment of the fact that the consumer did not request from the claim manager the settlement specified under section 7 (2) within thirty days following the publication on the website specified under section 16 paragraph (3).

(4) In the proceeding regulated pursuant to section 18 of Act XXXVIII of 2014, the rules specified therein shall cease to be applicable after 31 December 2016 at the latest.

Section 43/A In respect of proceedings regulated under section 18 of Act XXXVIII of 2014 that are based on a claims originating from consumer loan contracts secured by a mortgage lien, if the conditions specified under section 43 are met on 15 September 2015 or before, the time limit specified under section 43 shall commence on 16 day of September 2015.

(2) If the market value of the mortgaged residential property put up for sale is less than sixty million forints, no action can be taken with a view to the sale of the property in an auction on the basis of which the buyers may make a valid bid. In these cases, actions with a view to the sale of the residential property may only be taken if the time limits specified in section 104 (5) and (6) of Act CV of 2015 on the debt settlement of natural persons have already expired and the debtor, the co-debtor, surety or owner of the pledged item did not submit their request to initiate the proceeding with a view to debt settlement.

20. Accounting rules concerning the settlement

Section 44 The amount accounted as overpayment and refunded to the consumers as a result of the implementation of Act XXXVIII of 2014 and this Act in respect of the previous financial years shall be deemed by the financial institution as a major error pursuant to Act C of 2000 on accounting with the proviso that derogating from the requirements specified in section 19 (3) and section 37 (5) of Act C of 2000 on accounting, it shall be accounted as extraordinary expenditures included in the expenditures pertaining to the reporting period of the financial year when credit (settlement), payment (refund) were dated. In respect of the amount accounted as overpayment and refunded in respect of previous financial years, the provisions under section 170 of Act C of 2000 on accounting shall not apply.

Section 44/A In respect of forint-based consumer loan contracts, the financial institution shall comply with its settlement obligations towards the consumer pursuant to Act LXXVII of 2014 on the settlement of matters relating to the currency conversion of certain consumer loan contracts and interest rate rules, and this Act as of 30 June 2015 with the proviso that it shall include or record the impacts of the settlements in its internal registries concerning the client and its accounting registers by 30 September 2015,and if a civil proceeding launched by the financial institution or the Supervising Authority under this Act or Act XXXVIII of 2014 is terminated after 1 August 2015 then no later than the sixtieth day following the termination of the civil proceeding.

21. The prohibition of the unilateral increase of interest, cost and fee and special provisions on termination in respect of consumer loan contracts

Section 45 (1) The financial institution shall not have the right to unilaterally increase the interest, cost or fee until a date specified in a separate Act, but until 1 April 2016 at the latest in respect of consumer loan contracts.

(2) The financial institution may terminate the consumer loan contract due to the consumer's failure to fulfil his payment obligation becoming effective after the settlement specified in this Act is sent to the consumer and the arrears of the claim of the financial institution against the consumer may become due in a lump sum at the same time.

(3) The termination specified under paragraph (2) shall take effect on the day following the sending of the settlement but no later than 31 December 2016 and if, as a result of the settlement, the legal or contractual conditions of termination and loss of the right to repayment in instalments are met in relation to the consumer.

22. Final provisions

Section 46 The Governor of the Hungarian National Bank shall be authorised, as set out in section 4 (7) of the MNB Act, with respect to the macro-prudential tasks, in particular the prevention of systemic risks and other responsibilities as specified under section 4 (9) a) and d), to set forth in a decree

a) the detailed rules of the settlement method and the formulas thereof,

b) the rules, method and formulas of accounting for the reductions deductible from consumer's claims,

c) the detailed requirements of settlement in terms of content and form,

d)

e) the due dates of financial performance,

f) for financial institutions subject to winding up and liquidation procedure, the method of estimation specified in the MNB Decree in the course of settlement,

g) the requirements of disclosure on the website of the settlement in terms content and form, and *h*) other detailed rules necessary for the settlement and the enforcement of claims relating to the settlement.

Section 46/A The minister responsible for justice shall be authorised to specify in a decree the paper-based forms, their requirements in terms of form and content, the annexes that may be attached to the forms and the publication of the forms to be used in the civil proceedings regulated in this Act.

Section 47 (1) This Act, with the exception of paragraph (2), shall enter into force on 15 October 2014.

(2) Sections 1 to 45 and sections 48 to 51 shall enter into force on 1 November 2014.

Section 48 (1) The provisions of this Act as amended by Act LII of 2015 on the amendment of certain acts to combat malpractices in the course of banking settlements (hereinafter "Módtv.") shall also apply to proceedings in progress at the time of the entry into force of the Módtv.

(2) If, at the time when the Módtv. enters into force, the time limit pursuant to section 18 (1) has already commenced or expired, in respect of the person entitled to contest the settlement not indicated on the settlement as an addressee, the time limit of thirty days specified under section 18 (1) shall commence on the date when the Módtv. enters into force.

Sections 49-51

Section 52

Annex 1 of Act XL of 2014

The data to be provided on the form to be submitted as the extract of the financial institution

1. Mandatory data concerning the entity submitting the extract:
1.1. Name;
1.2. Seat;
1.3. The telephone number, fax number, e-mail address of the proceeding organisational unit;
2. Mandatory data concerning the content of the extract:
2.1. Type of financial service, its designation used by the entity submitting the extract;
2.2. Period of application, year, month, day;
2.3. Levels of regulations:
2.3.1. Contract clause not negotiated individually,
2.3.2. General Terms and Conditions,
2.3.3. Business regulations
2.3.4. Other;
2.4. The designation of documents representing the levels of regulation as used by the entity submitting the extract;
2.5. Relevant provisions of documents representing levels of regulation:
2.5.1. Interest-related provisions,

2.5.2. Cost-related provisions,
2.5.3. Fee-related provisions;
2.6. The name of the indication, numbering of the relevant provision for the purpose of identification within the document;
3. Other mandatory data:
3.1. Reference to the fact that the information sheet pursuant to this Act has been attached to the extract;
3.2. Information, warnings on the form:
3.2.1. Information on substantial legal effects,
3.2.2. Information on how to fill in the form;
4. Reference to the fact that the financial service indicated on the extract is a forint or a foreign exchange loan;
5. The declaration of the financial institution confirming that the content of the extract complies with the regulation it applies.

ACT LXXVII OF 2014

on the settlement of issues related to the conversion of the currency of certain consumer loan agreements and rules regarding interest

1. Scope of Act

1. §

(1) The scope of this Act shall extend to

a) credit and loan agreements and financial leasing agreements entered into by and between financial institutions and consumers which are not yet terminated on 1 February 2015 (hereinafter collectively referred to as „consumer loan agreement") and

b) debts arising from consumer loan agreements in existence at the time of the entry into force of this Act but already terminated by the financial institution and recorded by the financial institution or any other financial institution coming under collective regulatory supervision with the former as defaulted receivables

concluded between 1 May 2004 and the entry into force of Act XXXVIII of 2014 on the settlement of certain issues related to the Curia's legal unity decision concerning the consumer loan agreements of financial institutions (hereinafter referred to as Act XXXVIII of 2014), in connection with which an obligation of settlement lies with financial institutions on the basis of Act XL of 2014 on the rules of settlement laid down in Act XXXVIII of 2014 on the settlement of certain issues related to the Curia's legal unity decision concerning the consumer loan agreements of financial institutions, and certain other provisions (hereinafter referred to as the „Settlement Act").

(2) The scope of this Act shall not extend to

a) consumer loan agreements linked to credit cards or payment accounts, and

b) HUF-based consumer housing loan agreements provided with state interest subsidies.

2. Interpretative Provisions

2. §

(1) For the purposes of this Act:

a) *consumer loan agreement under the effect of the exchange rate cap*: the consumer loan agreement serving as the basis for the foreign currency loan defined in Section 1(1), paragraph 1 of Act LXXV of 2011 on the fixing of the amortisation exchange rate of foreign currency loans and the forced sale of housing properties (hereinafter referred to as the „Exchange Rate Cap Act");

b) BUBOR: Budapest inter-bank interest rate;

c) foreign currency-based loan agreement: a credit or loan agreement or financial leasing agreement recorded in a foreign currency or provided in a foreign currency and amortised in HUF;

d) foreign currency loan agreement: a foreign currency credit or loan agreement or financial leasing agreement not qualifying as foreign currency-based;

e*) original interest margin*:

ea) if the original initial interest is tied to a reference interest rate, the interest margin quoted upon the due date of the first amortisation instalment of the agreement or if the financial institution granted an interest margin discount for a pre-determined term of the agreement, the first interest margin to form part of the agreement after the expiry of the preferential period,

eb) if the original initial interest is not tied to a reference interest rate, the difference of the original initial interest and the arithmetic average of the three-month London inter-bank interest rate quoted for the given currency in the month of the disbursement of the loan amount;

f) original initial interest:

fa) except as set forth in fb), the interest quoted upon the due date of the first amortisation instalment of the agreement,

fb) if the financial institution granted an interest margin discount for a pre-determined term of the agreement, the first interest margin to form part of the agreement after the expiry of the preferential period;

g) original initial handling charge: the handling charge determined in the agreement or to form part of the agreement after the expiry of the preferential period;

h) original calculable interest, interest margin: the lower interest or interest margin of the original initial interest (interest margin in the case of agreement tied to a reference interest rate) and the transaction interest (interest margin in the case of agreement tied to a reference interest rate) applied in the given consumer loan agreement on 19 July 2014;

i) consumer: a consumer so defined in Section 6(1), paragraph 28 of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (hereinafter referred to as the „Credit Institutions Act");

j) effective day: the date determined on the basis of Section 6(5) of the Settlement Act;

k) forint-based loan agreement: a credit or loan agreement or financial leasing agreement disbursed and recorded in HUF which may only be repaid in HUF;

l) financial leasing for real estate: a financial leasing agreement, the purpose of which is, as committed to a deed by the parties, the acquisition by the lessee of title to real estate from a third party seller;

m) mortgage loan agreement: an agreement entered into for the provision of a mortgage loan as defined in Section 6(1), paragraph 50 of the Credit Institutions Act;

n) housing mortgage loan agreement: an agreement entered into for the provision of a mortgage loan as defined in Section 3, paragraph 22 of Act CLXII of 2009 on credit provided for consumers (hereinafter referred to as the „Consumer Credit Act");

o) financial institution: a financial institution as defined in Section 7(1) of the Credit Institutions Act;

p) financial leasing agreement: an agreement that satisfies the conditions set forth in Section 6(1), paragraph 89 of the Credit Institutions Act.

(2) For the purposes of this Act,

a) amortisation instalment shall also be construed as lease fee,

b) debt shall also be construed as a debt existing on the basis of a financial leasing agreement (including, in particular, the financing amount and the residual value).

(3) The rules defined in this Act with respect to consumer mortgage loan agreements shall also apply to financial leasing agreements for real estate.

3. Common Rules of the Amendment of Consumer Loan Agreements

3. §

(1) Consumer loan agreements shall be amended as set forth herein by the force of law.

(2) Financial institutions shall draft the texts of the provisions of consumer loan agreements and the associated collateral agreements, mortgage agreements and independent lien agreements (for the purposes of this Section hereinafter collectively referred to as „mortgage agreements") which are to be amended as set forth in this Act.

(3) Day of amendment of agreements

a) except as set forth in paragraphs b) and c), the day following the receipt by the consumer of the text of the amended provisions of the consumer loan agreement,

b) in the case of foreign currency or foreign currency-based consumer mortgage loan agreements – if the consumer does not avail himself/herself of the option defined in Section 12(1) –, the thirty-first day following the receipt by the consumer of the text of the amended provisions of the consumer loan agreement,

c) in the case of foreign currency or foreign currency-based consumer mortgage loan agreements – if the financial institution notifies the consumer that he/she does not satisfy any of the conditions laid down in Section 12(3) –, the day following the receipt of the notice referred to in Section 12(4).

(4) The effect of the amendment of the agreement shall set in retroactive to the effective day.

(5) Any lien and suretyship serving to secure the consumer loan agreement shall survive; the amendment of the agreement as set forth in this Act is not subject to the consent of the surety, including a state surety, and – if the obligor of the consumer loan agreement and the lien obligor are not one and the same person – of the lien obligor. However, their status may not become any more cumbersome in consequence of such amendment.

(6) If the consumer loan agreement amended under this Act was refinanced through the purchase of an independent lien as defined in Act XXX of 1997 on mortgage credit institutions and mortgage deeds or the provision of a refinancing mortgage loan, the legal relationship relating to refinancing shall also be amended by the force of this Act in accordance with the terms and conditions of the consumer loan agreement amended under this Act. The forint amount of refinancing shall be adjusted to the amount of the debt converted into forints on the basis of Section 10. The contractual terms and conditions of refinancing shall be amended on the basis of the written notice sent by the financial institution to the mortgage credit institution retroactive to the effective day.

4. §

(1) The amended consumer loan agreement need not be committed to a notarial deed; the former notarial deed shall be valid within the boundaries of the amended content of the agreement.

(2) The amendment of the consumer loan agreement under this Act and the conversion of the debt defined in Section 15(1) into forints as set forth in this Act shall not prevent the notary public drafting the deed from furnishing the

a) notarial deed drafted of the consumer loan agreement,

b) notarial deed containing a declaration of unilateral commitment made by the consumer on the basis of a consumer loan agreement committed to a private deed, or

c) notarial deed stating the claim secured by mortgage of any kind in connection with the consumer loan agreement

with a clause of execution. The furnishing of the notarial deed with a clause of execution may only be requested in accordance with the amended consumer loan agreement and the debt converted into forints on the basis of Section 15(1).

(3) In the event of the enforcement of a lien outside court execution, the right of satisfaction may only be exercised up to the amount of the consumer loan agreement amended under this Act and the debt converted into forints on the basis of Section 15(1).

(4) If the executable deed has not been issued yet, the party seeking execution shall report the change in its claim under this Act simultaneously with the fulfilment of its obligation of reporting under Section 41(9) of the Settlement Act.

(5) During the course of court execution in progress on the basis of a public deed already furnished with a final and absolute clause in respect of the debt referred to in Section 15(1), the party seeking execution shall report the change in the debt under this Act simultaneously with the fulfilment of its obligation of reporting under Section 41(2) of the Settlement Act.

(6) The mortgage registered as collateral securing the original consumer loan agreement shall continue to secure the consumer loan agreement amended on the basis of this Act; the mortgage recorded in the real estate register need not be amended in the event of a change in the currency of the debt.

(7) If the currency of the mortgage encumbering real estate which was established to secure the consumer loan agreement is different from the currency of the consumer loan agreement amended by the force of this Act, upon the determination of the amount of the registered mortgage in forints, the exchange rate determined in Section 10 shall be applied.

5. §

(1) The financial institution shall send the text of the amended provisions of the consumer loan agreement, together with the statement of settlement under the Settlement Act, to the address determined in Section 16(1) of the Settlement Act by mail, with acknowledgement of receipt.

(2) The following shall be enclosed with the communication under subsection (1):

a) a summary of the material elements of the amendment as defined in the decree of the Governor of the National Bank of Hungary (hereinafter referred to as the „NBH"),

b) an amortisation table containing the amortisation instalments falling due during the remaining term as of the effective day,

c) a notice alerting the consumer to the right of termination set forth in Section 13,

d) a notice alerting the consumer to the possibility of initiating the procedure referred to in Section 12 and, in conjunction with this,

da) a list of the documents to be submitted by the consumer for the calculation of the income-proportionate amortisation instalment and the income-proportionate amortisation instalment indicator under the legal rule on the regulation of credit coverage ratios (hereinafter referred to as „IPAII"),

db) drawing attention to the existence of the conditions set forth in Section 12(3), paragraphs c) and d), and

dc) in the case of consumer loan agreements under the effect of the exchange rate cap, a warning alerting the consumer to make the written declaration referred to in Section 12(3).

6. §

(1) The consumer shall pay the amortisation instalment payable on the basis of the amendment under this Act for the first time in the month following the last day of the time limit determined in Section 13(1) and (2) of the Settlement Act that is available for sending the settlement statement.

(2) After the financial institution ascertains the amount of the difference between the amortisation payments paid up to the date referred to in subsection (1) and payable as of the effective day, the financial institution

a) shall forthwith transfer the amount of the difference to the consumer's payment account – if the financial institution is aware of the number of the consumer's payment account – and shall inform the consumer thereof in its next notice concerning the change in the amortisation instalments,

b) shall forthwith inform the consumer – if the financial institution is not aware of the number of the consumer's payment account – that it will transfer the amount of the difference to his/her payment account as soon as it is made aware of the number thereof and that, in the absence of such information, the consumer may collect the difference from the financial institution in cash.

7. §

(1) In the case of consumer loan agreements amended under this Act, the term of the interest period (in the case of interest tied to a reference interest rate, the interest margin periods) shall be as follows:

a) if the remaining term reckoned from the effective day exceeds 16 years, it shall be five years,

b) if the remaining term reckoned from the effective day exceeds 9 years but is maximum 16 years, it shall be four years,

c) if the remaining term reckoned from the effective day exceeds 3 years but is maximum 9 years, it shall be three years.

(2) The initial day of the first new interest period or interest margin period following the entry into force of this Act shall be the day of the month that corresponds to the day and month of the effective day of the transaction year determined in the original consumer loan agreement during the period between 1 May 2015 and 30 April 2016.

(3) If there is no day corresponding to the initial day of the interest period or interest margin period in the month of the given year, the initial day of the interest period or interest margin period shall be the last day of the month.

(4) The term of the last interest period or interest margin period may be shorter than the term determined in subsection (1).

8. §

(1) The amendment after the effective day of consumer loan agreements amended under this Act shall be governed by the provisions of the Consumer Credit Act, unless this Act provides otherwise.

(2) If the interest of the consumer loan agreement amended under this Act
a) is fixed during the interest periods, the rate of the interest
b) is tied to a reference interest rate, the rate of the interest margin
may for the first time only be altered to the consumer's detriment as set forth in the Consumer Credit Act as of the initial day of the second interest period following the entry into force of this Act.

9. §

(1) Any fees, commissions and charges which were validly established in the consumer loan agreement prior to the entry into force of this Section shall remain part of the agreement.

(2) The financial institution shall be entitled to raise any fees, commissions and charges determined on an itemised basis once annually, effective as of 1 April – for the first time, as of 1 April 2016 – maximum by the rate of the previous year's annual consumer price index published by the Central Statistical Office.

(3) The financial institution may not charge the consumer any fee, cost or commission in connection with the amendment under this Act.

4. Foreign Currency and Foreign Currency-Based Mortgage Loans

10. §

The financial institution that is the beneficiary of the given foreign currency or foreign currency-based mortgage loan agreement shall, by the deadline for the fulfilment of its obligation of settlement under the Settlement Act, convert the total debt existing on the basis of or arising from the foreign currency or foreign currency-based consumer mortgage loan agreement as determined on the basis of the settlement rendered in accordance with the Settlement Act, including any interest, fees, commissions and costs charged in a foreign currency, into a forint claim as of the effective day at one of the following exchange rates, whichever is more favourable for the consumer:

a) the average of the foreign exchange rates of the given currency officially quoted by the NBH between 16 June 2014 and 7 November 2014, or

b) at the foreign exchange rate of the given currency officially quoted by the NBH on 7 November 2014

(hereinafter referred to as „forint conversion").

11. §

(1) In the event of forint conversion upon the amendment of a foreign currency or foreign currency-based consumer mortgage loan agreement, the financial institution may only use interest that is tied to a reference interest rate.

(2) The applicable reference interest rate is the three-month BUBOR.

(3) The first day of the second interest period of the reference interest rate:

a) if the beginning of the first new interest margin period falls between 1 May 2015 and 1 August 2015, it is that day,

b) in all other cases, it is the day of the month after 30 April 2015 which may be determined by counting back three months from the initial day of the first new interest margin period.

(4) The interest margin is the original interest margin, with the proviso that

a) it cannot be less than 1 per cent, and

b) may not exceed

ba) 4.5 per cent in the case of housing consumer mortgage loan agreements or

bb) 6.5 per cent in the case of non-housing consumer mortgage loan agreements.

(5) If the consumer mortgage loan agreement also contains an original initial handling charge expressed as a percentage, the rates of the interest margins referred to in subsection (4), paragraph b) shall be taken into consideration at a rate reduced by the percentage point of the original initial handling charge.

(6) The initial interest determined by virtue of the amendment under this Act may not exceed the originally calculable interest, unless this interest is lower than the minimum initial interest that may be determined on the basis of this Section.

12. §

(1) The consumer may, within thirty days of the receipt of the amended provisions of the consumer mortgage loan agreement, initiate with the credit institution the dispensation of

the forint conversion defined in Section 10 and of the application of the interest rules defined in Section 11 in writing, with the content and in the form determined in the decree of the Governor of the NBH.

(2) In the case of co-debtors, the procedure referred to in subsection (1) may be initiated on the basis of the joint and concordant statement of the co-debtors.

(3) The consumer may avail himself/herself of the option under subsection (1) if

a) he/she verifies that he/she has a regular income of an amount in excess of the expected amortisation instalment in the currency quoted by the NBH as an official exchange rate – which shall be construed as a combined income in the case of co-debtors, or

b) based on the IPAII, he/she should be eligible to obtain the given foreign currency-based loan and encloses the documents necessary for the verification thereof determined by the financial institution on the basis of Section 5(2), paragraph d), sub-paragraph da), or

c) the remaining term of the consumer mortgage loan agreement expires on 31 December 2020, at the latest, or

d) the calculable initial interest in the case of forint conversion based on this Act exceeds the interest or interest margin originally calculable on the basis of subsection (7),

and, in the case of a consumer loan agreement under the effect of the exchange rate cap, the consumer makes a written declaration to the financial institution in acknowledgement of the fact that, as of the effective day, the financial institution will not provide the forint amount of the difference between the amortisation exchange rate applied by it and the exchange rate fixed in the Exchange Rate Cap Act through disbursement from the collection account credit under the Exchange Rate Cap Act.

(4) The financial institution shall assess the existence of the conditions laid down in subsection (3) within thirty days of the receipt of the procedure initiated under subsection (1) and shall forthwith notify the consumer thereof in a letter sent by mail, with acknowledgement of receipt.

(5) If the consumer satisfies any of the conditions laid down in subsection (3), the financial institution shall send the consumer the amended provisions of the foreign currency or foreign currency-based consumer mortgage loan agreement and the enclosures relating to the amended foreign currency or foreign currency-based consumer mortgage loan agreement set forth in Section 5(2), paragraphs a) and b) within sixty days of the assessment.

(6) If the consumer satisfies any of the conditions laid down in subsection (3), the amortisation instalments of the foreign currency or foreign currency-based consumer mortgage loan agreement falling due monthly and the forint amount of any charge, fee or commission determined in a foreign currency shall be determined on the basis of the foreign exchange rate defined in Section 21/B(1) and (2) of the Consumer Credit Act as of the effective day.

(7) If the consumer satisfies any of the conditions laid down in subsection (3) and the interest of the original foreign currency or foreign currency-based mortgage loan agreement

a) is fixed during the interest periods, the initial interest of the foreign currency or foreign currency-based consumer mortgage loan agreement applicable as of the effective day may not exceed the originally calculable interest;

b) is tied to a reference interest rate, the initial interest margin applicable as of the effective day may not exceed the originally calculable interest margin.

(8) If the consumer does not satisfy any of the conditions laid down in subsection (3), the consumer mortgage loan agreement shall be amended under the conditions set forth in Sections 10 and 11.

13. §

(1) If the foreign currency or foreign currency-based consumer mortgage loan agreement is changed to a forint-based consumer mortgage loan agreement under this Act, the consumer may terminate the consumer mortgage loan agreement within 60 days of the amendment.

(2) In the event of termination under subsection (1), the consumer shall pay the financial institution all his/her debts outstanding on the basis of the terminated agreement within 90 days of termination.

(3) If the consumer enters into a new consumer mortgage loan agreement with the financial institution or another financial institution in the interest of the fulfilment of his/her payment obligation under subsection (2),

a) the financial institution affected by such termination may not charge the consumer any fee, cost or commission in connection with the fulfilment of the payment obligation,

b) the mortgage serving to secure the new consumer mortgage loan agreement shall have the ranking of the mortgage registered on the basis of the original consumer mortgage loan agreement maximum up to the amount used for the fulfilment of the payment obligation referred to in subsection (2) from the new consumer mortgage loan agreement, and

c) the new consumer mortgage loan agreement need not satisfy the conditions laid down in the legal rule on the regulation of the income-proportionate amortisation instalment and credit coverage ratios if

ca) the new consumer mortgage loan agreement is forint-based,

cb) the credit purpose of the new consumer mortgage loan agreement is the same as the credit purpose of the original consumer mortgage loan agreement, and

cc) the loan amount of the new consumer mortgage loan agreement does not exceed the amount of the payment liability under subsection (2).

(4) The intermediary shall not be entitled to charge its principal a fee for the mediation of financial services relating to forint-based consumer loans provided with a view to the full or partial repayment of the debt referred to in subsection (2).

5. Forint-Based Consumer Loan Agreements and Foreign Currency and Foreign Currency-Based Consumer Loan Agreements Not Provided Against Mortgage Security

14. §

In the case of forint-based consumer loan agreements and foreign currency and foreign currency-based consumer loan agreements not provided against mortgage security, the interest or interest margin applicable as of the effective day may not exceed the originally calculable interest or interest margin.

6. Conversion of Certain Debts into Claims Denominated in Forints

15. §

(1) Effective as of 1 February 2015, the financial institution shall convert the amount of the consumer's debt arising from a foreign currency or foreign currency-based consumer mortgage loan agreement terminated by the credit institution but recorded by the financial institution or any other financial institution coming under collective regulatory supervision with the former as defaulted receivables, as determined on the basis of the settlement rendered in accordance with the Settlement Act, into a claim denominated in forints at one of the following exchange rates, whichever is more favourable for the consumer:
a) the average of the foreign exchange rates of the given currency officially quoted by the NBH between 16 June 2014 and 7 November 2014, or
b) at the foreign exchange rate of the given currency officially quoted by the NBH on 7 November 2014.

(2) The financial institution shall notify the consumer of the conversion referred to in subsection (1) and the amount of the debt outstanding in forints on the basis thereof, together with the settlement statement under the Settlement Act, whilst drawing attention to the option mentioned in subsection (3), in a letter sent by mail, with acknowledgement of receipt.

(3) If initiated by the consumer with the financial institution in writing, within 30 days of the receipt of the notification under subsection (2), the financial institution shall re-convert the claim converted into forints into a claim denominated in the original currency at the exchange rate determined in subsection (1).

7. Review

16. §

(1) If the consumer

a) did not receive the information on the amendment of the agreement under this Act and the related documents or the information referred to in Section 15(2) within the prescribed time limit, or

b) disputes the calculation of the conversion of the claim expressed in forints under Sections 10 and 15, the calculation of the interest, or the adequacy of the data and calculations contained in the amortisation table stating the new amortisation instalments,

the consumer may request a review in accordance with the rules set forth in Sub-Title 11 of the Settlement Act, except as set forth in subsections (2) and (3).

(2) For the purposes of subsection (1), the provision set forth in Section 18(4) of the Settlement Act is not applicable.

(3) In the event referred to in paragraph (1) a), the consumer may file a complaint with the financial institution within the time limit determined in Section 18(1) of the Settlement Act.

(4) Wherever Sub-Title 11 of the Settlement Act mentions settlement statement, it shall be construed as to also include the documents referred to in Section 5(1) and (2), Section 12(5) and Section 15(2), with the proviso that the consumer may also request the establishment of the fact that the financial institution would have been required to send these under this Act.

8. Rules of Delivery

17. §

Wherever this Act prescribes a notice to be sent by mail with acknowledgement of receipt, the delivery day is the day that may be determined on the basis of the rules of delivery of the Settlement Act, subject to the difference that if such notice is sent back with the message „address cannot be identified, „addressee unknown", „moved", „delivery obstructed" or „reported: deceased", it is the day of re-delivery.

9. Different Rules Applicable to Consumer Loan Agreements Under the Effect of the Fixing of the Amortisation Exchange Rates of Foreign Currency Loans

18. §

(1) The rules defined in this Act with respect to consumer loan agreements and the rules of the Exchange Rate Cap Act relating to the fixing of the amortisation exchange rates of foreign currency loans, the collection account credit agreement and the collection account credit shall apply subject to the differences under this sub-title.

(2) In the case of consumer loan agreements equally under the effect of the exchange rate cap and forint conversion on the basis of this Act, as of the amortisation instalment due in February 2015 until the amortisation instalment due in the sixtieth month reckoned from the initial day of the period of the application of the fixed exchange rate determined in the Exchange Rate Cap Act, the amortisation instalment may not exceed the amortisation instalment due in January 2015, not including any increase in the amortisation instalment arising from any interest changes calculable on the basis of this Act.

(3) In the case of loan agreements under the effect of the exchange rate cap, if a collection account credit debt expressed in forints remains outstanding after the settlement defined in Section 12 of the Settlement Act, collection account credit agreements and collection account credit shall be governed by the rules in force on the day before the entry into force of this Act, with the proviso that the collection account credit may not increase as of the effective day, not including any interest that may be charged to the debit of the collection account credit as defined in the Exchange Rate Cap Act.

(4) In the case of the consumer loan agreements defined in subsection (2), the financial institution shall determine the remaining term after the effective day in such a way that the amortisation instalments falling due after the sixtieth month reckoned from the initial day of the period of the application of the fixed exchange rate determined in the Exchange Rate Cap Act may not exceed 115 per cent of the amortisation instalments falling due in the sixtieth month reckoned from the initial day of the period of the application of the fixed exchange rate determined in the Exchange Rate Cap Act, or if this rate cannot be guaranteed, the amortisation instalment at the rate that is the most favourable for the consumer.

(5) The detailed rules of the calculation of the term defined in subsection (4) shall be determined by the minister responsible for the regulation of the money, capital and insurance markets in a decree.

(6) In the case of the consumer loan agreements defined in subsection (2), the consumer may, at any time until the sixtieth month reckoned from the initial day of the period of the application

of the fixed exchange rate determined in the Exchange Rate Cap Act, initiate the amendment of the consumer loan agreement, based on which the consumer would pay a higher amortisation instalment than that determined therein also during the period referred to in subsection (2). The parties shall amend the agreement as initiated as of the due date of the first amortisation instalment falling due after a period of thirty days following the receipt of the initiated amendment.

10. Closing Provisions

19. §

(1) The Governor of the NBH is hereby authorised to establish the content and formal requirements relating to the

a) summary regarding the material elements of the contract amendment, and

b) the initiation of the procedure defined in Section 12(1)

by proceeding within his/her responsibilities identified in Section 4(9) of Act CXXXIX of 2013 on the National Bank of Hungary.

(2) The minister responsible for the regulation of the money, capital and insurance markets is hereby authorised to establish the detailed rules of the calculation of the term defined in Section 18(4) in a decree.

20. §

(1) Except as set forth in subsection (2), this Act shall enter into force on the day following its promulgation.

(2) Section 3, Section 4(1), Sections 5-14, Section 18(4) and (5), Section 21(2) and Section 22 shall enter into force on 1 February 2015.

21. §

(1) After 1 January 2015 – also until the payment of the amortisation instalment payable on the basis of the amendment under this Act for the first time –, upon determining the forint amount of the due amortisation instalment of the foreign currency or foreign currency-based consumer mortgage loan agreement as well as the forint amount of any charge, fee or commission determined in a foreign currency, the financial institution shall apply one of the following exchange rates, whichever is more favourable for the consumer:

a) the average of the foreign exchange rates of the given currency officially quoted by the NBH between 16 June 2014 and 7 November 2014, or

b) at the foreign exchange rate of the given currency officially quoted by the NBH on 7 November 2014.

(2) If the consumer satisfies any of the conditions laid down in Section 12(3), the financial institution shall account for the difference arising from the difference between the exchange rate defined in subsection (1) and the exchange rate applicable under the amended agreement to the debit or credit of the next due amortisation instalment falling due within 30 days of the amendment of the agreement, at the latest.

(3) In the case of foreign currency or foreign currency-based consumer mortgage loan agreements altered to forint-based agreements, the financial institution shall complete the settlements under this Act and the Settlement Act with the customer as at 1 February 2015, with the proviso that it shall transfer and record the consequences of such settlements in its internal records relating to the customer and in its accounting records by 31 March 2015.

(4) The financial institution shall meet its obligation of providing information in connection with consumer loan agreements prescribed in the Credit Institutions Act and the Consumer Credit Act in combination with the settlement under the Settlement Act between 1 January 2015 and the last day of the time limit available for the sending of settlement statements determined in Section 13(1) and (2) of the Settlement Act.

(5) In the case of consumer loan agreements under the effect of the exchange rate cap, upon disbursement from the collection account credit defined in the Exchange Rate Cap Act, the exchange rate defined in subsection (1) shall be regarded as the amortisation exchange rate applied by the financial institution in January 2015.

22. §

Section 32/C(1) of Act LXXXV of 1996 on the amendment of Act XCIII of 1990 on duties and the administrative service fee of certified official title deeds shall be supplemented with the following paragraph q):

(Free of charge by virtue of its subject-matter:)

„q) entry in the real estate register of mortgage securing new consumer loan agreements under Section 13(3) of Act … of 2014 on the settlement of issues related to the conversion of the currency of certain consumer loan agreements and rules regarding interest, and deletion of mortgage securing consumer mortgage loan agreements terminated on the basis of Section 13(1) of Act … of 2014."

23. §

The Exchange Rate Cap Act shall be supplemented with the following Section 18/A:

„18/A. § New credit facility agreements relating to collection account credit may not be initiated after the day of the entry into force of Act … of 2014 on the settlement of issues related to the conversion of the currency of certain consumer loan agreements and rules regarding interest."

ACT CLXII OF 2009

on Credit Provided for Consumers[1]
Scope of Act

1. § (1) The provisions of this Act shall apply to credit provided for consumers.

(2) The provisions of this Act need not apply to the following:

a) hiring or lease which does not create an obligation of purchase for the consumer with respect to the object constituting the subject-matter of hiring or lease or does not provide a right for the creditor to prescribe an obligation to purchase,

b) overdraft facilities attached to payment accounts if the loans provided on the basis thereof must be repaid within one month,

c) credit, in respect of which the consumer has no obligation to pay credit interest or any other consideration,

d) employer credit which is not available to members of the public and in conjunction with which the employee is obliged to pay credit interest and any other consideration at an annual percentage rate that is lower than the customary market rate or is not obliged to pay credit interest or any other consideration,

e)[2] the investment credit defined in Act CXXXVIII of 2007 on investment enterprises and commodities exchange service providers and the rules of the activities which they may pursue,

f) credit created by a court of law,

g) credit which relates to the rescheduling of an existing debt free of interest and any other consideration,

h)[3] credit defined by law or a legal rule issued on the basis of the authorisation of a law with a view to public interests which is provided within a limited range and interest-free or where the applicable credit interest rate is lower than the customary market rate or which is provided at the customary market credit interest rate but under terms and conditions that are more favourable for the consumer than the customary market terms and conditions; including bridging loans as defined in Act IV of 2009 on the joint and several state suretyship relating to housing loans, collection account credit as defined in the law on the fixing of the amortisation exchange rate of foreign currency loans and the forced sale of housing properties, and student loans provided under a separate legal rule.

(3) The provisions of this Act shall apply to financial leasing provided for consumers, with the proviso that wherever this Act mentions credit, it shall be construed as financial leasing, and wherever this Act mentions amortisation instalment, it shall be construed as lease fee for the purposes hereof.

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1 Promulgated: 30 December 2009.

2 Amended by Section 96 of Act XCVIII of 2013.

3 Established by Section 16 of Act LXXV of 2011. In force as of 12 August 2011.

(4) The provisions of this Act shall be applied in harmony with the rules of the obligations of cooperation and information that lie with the parties under Section 6:62 of Act V of 2013 on the Civil Code.

(5) The provisions of this Act related to the information obligation and, if the surety or the lien obligor has a material legal interest therein, the provisions related to early repayment shall be applied in the manner laid down in the decree of the minister responsible for the regulation of the money, capital and insurance markets in the case of consumer suretyship agreements and consumer lien agreements attached to credit agreements in respect of the surety and the lien obligor not qualifying as a personal debtor.

2. § (1) The provisions of Section 17/B(2)–(4), Sections 17/C–17/E, Section 18(1)-(2) and Section 20/A need not apply to credit attached to credit card agreements or payment accounts.

(2) In the case of credit facilities attached to payment accounts where the loans provided must be repaid within three months or at the creditor's notice, Section 4(2), paragraphs d), f) and g), Section 4(3), Section 5, Section 6(1), paragraphs 6., 9–14, 16–19 and 21, Section 6(2)–(5) and (7), Section 10, Section 12, Section 13, Section 16(1), paragraphs 6 and 9–24, Section 17, Section 18(3) and (6), Sections 20–21, Section 21/B, Section 23, Section 24(1)–(4), (6) and (7) and Section 25 need not apply.

(3) In the case of overrunning, Sections 4–25 need not apply.

(4) Section 4(1)–(2), Section 6, Sections 8–11, Section 16(1), paragraphs 9, 11, 19 and 20 and (4), Section 17(1), Sections 19–20, Sections 21-22, Section 24 and Section 26 need not apply to mortgage loans and financial leasing.

(5) The provisions of this Act shall apply to credit provided with state interest subsidies subject to the differences laid down in a separate legal rule.

Interpretative Provisions

3. § For the purposes of this Act:

1. *early repayment*: full or partial repayment of a debt existing on the basis of a credit agreement prior to the repayment date,

2. *overdraft facility agreement attached to payment account:* a credit agreement, by virtue of which the creditor places an amount at the consumer's disposal that is in excess of the balance of the consumer's payment account,

3. *consumer*: a natural person proceeding beyond the scope of his/her independent occupation and business activities,

4. *full amount payable by consumer:* the full amount of the credit and the totality of the charges payable thereon,

5. *creditor:* a legal entity who or which provides loans within the framework of its independent occupation or business activities,

6. *credit interest:* a sum of money fixed annually as a fixed or variable percentage of the sum of credit drawn by the consumer,

7. *credit intermediary:* a legal entity, other than a creditor, who engages in the following activities within the framework of its independent occupation or business activities against a consideration, including any fees, commissions or charges:

a) offering credit to consumers, or

b) providing assistance for consumers in the interest of the conclusion of credit agreements, or

c) entering into credit agreements with consumers on behalf of creditors,

8. *credit*: a service provided on the basis of a credit agreement,

9. *credit agreement*: a credit agreement or a loan agreement as defined in the Act on the Civil Code, not including an agreement, on the basis of which the consumer makes instalment payments against the continuing provision of services or the sale of the same product in the same quantities,

10. *total credit charge:* all considerations known to the creditor and to be taken into consideration upon the calculation of the annual percentage rate under a separate legal rule, which are payable by the consumer on the basis of the credit agreement,

11. *total credit amount:* the full sum of the credit determined in the credit agreement or the upper limit thereof,

12. *overrunning:* credit attached to a payment account which the creditor places at the consumer's disposal as an amount in excess of the amount stated in the overdraft facility agreement or in the absence of such agreement,

13.[4] *mortgage loan*: the term so defined in the Credit Institutions Act,

14. *interest period*: a period determined in the credit agreement during which the creditor is not entitled to unilaterally alter the interest rate,

15. *linked credit agreement:* a credit agreement which is attached to the sale of a specified product or the provision of a service other than lending if

a) the credit is provided by the seller of the product or the provider of the service itself, or

b) the credit is provided by a third party and it uses the seller of the product or the provider of the service as intermediary during the course of the preparation or conclusion of the credit agreement, or the given product or service, to the sale or provision of which the credit agreement is attached was expressly specified in the credit agreement,

16.[5] *financial leasing:* the term so defined in the Act on Credit Institutions and Financial Enterprises (hereinafter referred to as the „Credit Institutions Act"),

17. *reference interest rate:* the term so defined in the Credit Institutions Act,

18. *fixed credit interest:* a credit interest rate determined in the credit agreement upon the conclusion thereof for the entire term of the credit agreement with the use of a single percentage rate or multiple percentage rates relating to parts of the term; the credit interest may only be regarded as fixed for the period, in respect of which its percentage rate was determined in the credit agreement,

19. *durable medium:* the term so defined in the Credit Institutions Act,

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4 Established by Act 128(1) of Act CCXXXVI of 2013. In force as of 1 January 2014.

5 Amended by Section 130a) of Act CCXXXVI of 2013.

20. *annual percentage rate:* the ratio of the total credit charge to the full sum of the credit expressed in percentage per annum,

21. *variable credit interest:* any interest that does not qualify as fixed credit interest,

22.[6] *housing mortgage loan:* a mortgage loan

a) as part of which the credit purpose laid down by the parties in a deed is the purchase, construction, enlargement, modernisation or refurbishment of a housing property,

b) which was used, based on documentary evidence, for the replacement of a mortgage loan provided for the purposes determined in paragraph a) and the amount of which may only exceed the amount outstanding at the time of the replacement of the original credit debt on account of the relevant exchange rate differences between the creditors and by the verified fees and charges that are related to the closure of the original credit debt and the disbursement of the new loan,

23.[7] *housing financial leasing:* a lease, the purpose of which, as laid down by the parties in a deed, is the acquisition by the lessee of title to a housing property from a third party seller,

24. *interest modification indicator:* a relative number accessible to the public which serves as the basis for the calculation of any interest modification and which objectively expresses any change in circumstances related to the refinancing costs of lending and the provision of credit that fall beyond the range of business risks and the control of creditors, are independent of creditors, and cannot be prevented or controlled by creditors,

25. *interest margin:* interest payable over and above the reference interest rate as part of the credit interest, the part of the interest defined as the difference of the credit interest and the reference interest,

26. *interest margin modification indicator:* an interest modification indicator serving as the basis for the alteration of the interest margin.

Commercial Communication Relating to Credit Products

4. § (1) The annual percentage rate shall be stated in every instance in any commercial communication relating to credit products prominently, by using the relevant abbreviation, to the accuracy of one decimal point.

(2) If a commercial communication relating to a credit product features figures that relate to the credit interest or any other consideration, including any fees, commissions and charges, in addition to the value of the annual percentage rate, such commercial communication shall clearly, concisely and prominently also feature the following items of data based on the demonstration of a representative example:

a) rate and type of credit interest (fixed credit interest, variable credit interest or both),

b) total credit charge, including the fees, commissions, charges and taxes forming part thereof,

c) full amount of credit,

[6] Established by Section 128(2) of Act CCXXXVI of 2013. In force as of 1 January 2014.

[7] Promulgated by Section 6 of Act XCVI of 2010. In force as of 27 November 2010.

d) term of credit,

e) annual percentage rate,

f) in the case of credit provided in the form of deferred payment in connection with the sale of products or the provision of services, the cash price of the product or service and the own resources, and

g) the full amount payable by the consumer and the amounts of the amortisation instalments.

(3) If the use of an ancillary service attached to the credit product (e.g. insurance) is necessary for the conclusion of the credit agreement or the conclusion of the credit agreement as per the creditor's offer and the consideration payable for the ancillary service attached to the credit product is not known, the obligation to enter into a agreement with respect to the ancillary service attached to the credit product shall also be clearly, concisely and prominently stated in the commercial communication relating to the credit product, in combination with the annual percentage rate.

(4) Credit intermediaries shall state in any commercial communication relating to credit products on whose behalf they proceed.

Pre-Contractual Information

5. § (1) Prior to the conclusion of credit agreements, creditors and credit intermediaries shall provide pre-contractual information for the consumer, on the basis of which the consumer may assess whether the credit product intended to be used is adapted to his/her needs and financial capacity. As part of this, the creditor or credit intermediary shall place at the consumer's disposal the information necessary for comparing different offers in order to enable the consumer to make an informed decision on the possible conclusion of the credit agreement.

(2) The information under subsection (1) shall, above all, extend to the most important characteristics of credit products, the impacts thereof on the consumer's financial situation, and the consequences of defaulting on payments, in particular, the default interest rate, the termination of the credit, and the enforcement of the collateral provided.

(3) The information under subsection (1) shall be provided in a concise and informative manner so as to ensure that it is comprehensible and transparent to the consumer and to demonstrate on the basis of representative examples the burden which the repayment of the credit will impose relative to the consumer's income situation and any changes therein, and any further risks which the consumer is to reckon with during the course of the repayment of the credit, including any interest and exchange rate risks.

(4) In the interest of providing pre-contractual information for consumers, creditors shall make the most typical sample texts of their credit agreements and mortgage agreements for each product group accessible on their Internet websites.

(5) The detailed rules of the method and form of the provision of the information regulated in this Section shall be determined by the minister responsible for the regulation of the money, capital and insurance markets.

6. § (1) In addition to the information under Section 5, in the interest of the comparison of credit agreement offers and the adoption of informed consumer decisions on the conclusion of credit agreements, creditors and credit intermediaries shall, in good time but before any offer or credit agreement becomes binding on the consumer, inform the consumer of the following data in respect of the credit product that may be considered on the basis of the information supplied by the consumer on paper, by using the form attached hereto as Annex 1, or any other durable media:

1. type of credit,
2. name (company name) and mail address of creditor,
3. creditor intermediary's name (company name) and mail address,
4. full amount of credit and drawdown conditions,
5. term of credit,
6. in the case of credit provided in the form of deferred payment in conjunction with the sale of a product or the provision of a service, description and cash price of the given product or service,
7. the credit interest and credit interest conditions, the relevant reference interest rate if any, the interest margin, the interest modification or interest margin modification indicator, and the frequency, conditions and procedural rules of the modification of the credit interest,
8. the annual percentage rate with a representative example, including all relevant conditions,
9. the full amount payable by the consumer on the basis of the conditions known at the time of the conclusion of the agreement,
10. the amounts of the amortisation instalments payable by the consumer, number of amortisation instalments and frequency of amortisation, and order of accounting for amortisation instalments towards different credit interest debts,
11. all commissions, fees, charges or other payment liabilities related to payment accounts or cash substitute payment instruments, unless the maintenance of the payment account or cash substitute payment instrument is not mandatory,
12. all further considerations attached to the credit beyond the credit interest, including all fees, commissions (hereinafter collectively referred to as „fees") and charges, and the conditions of their modification,
13. any notarial fees where applicable,
14. any ancillary services attached to the credit (e.g. insurance) which are necessary for the conclusion of the credit agreement or the conclusion thereof as per the creditor's offer,
15. default interest or any other payment liability which may arise from the non-fulfilment of the obligation undertaken in the agreement,
16. consequences of non-payment,
17. identification of required collateral,
18. right of withdrawal or the lack thereof,
19. right of early repayment and the costs thereof under Section 24 if any,
20. the obligation under Section 14(4),
21. the obligation under Section 9, and

22. any temporal restriction on the validity of the data supplied.

(2) If the conditions of the application of the various credit interest rates under subsection (1)7 are different, information shall be supplied with respect to the frequency, conditions and procedural rules of the modification of the credit interest in the case of every credit interest rate.

(3) If, based on the data supplied, the consumer identifies the characteristics of the preferred credit product of his/her choice, the creditor or credit intermediary shall provide information on the annual percentage rate and the full amount payable by the consumer on the basis thereof.

(4) If, based on the credit agreement, the credit may be drawn upon in multiple manners and these result in different credit interest rates or other considerations payable beyond the credit interest, including any fees and charges, and the consumer took account of the most frequent drawdown method in the case of the given credit type, the creditor or the credit intermediary shall state as part of the pre-contractual information that other drawdown methods may result in a higher annual percentage rate.

(5) If the instalments paid by the consumer do not forthwith result in the amortisation of the credit amount but are used to constitute capital during the periods and under the conditions defined in the credit agreement or an agreement attached thereto, as part of the pre-contractual information under subsection (1), the creditor or the credit intermediary shall clearly and concisely inform the consumer that payment of the instalments does not automatically result in the repayment of the full credit amount, unless the parties expressly so agree.

(6) In the case of an overdraft facility attached to a payment account, the creditor or the credit intermediary shall inform the consumer of the following by using the form attached hereto as Annex 2:

a) the data referred to in paragraphs 1–5, 7, 8, 15, 20 and 22 in subsection (1) above,

b) conditions and method of termination of facility,

c) in the case of an overdraft facility attached to a payment account, based on which the loan provided must be repaid at the creditor's notice, information to the effect that the creditor is entitled to demand the repayment of the full credit amount at any time, and

d) in the case of an overdraft facility attached to a payment account, based on which the loan provided must be repaid within three months or at the creditor's notice, all other considerations that may emerge after the conclusion of the agreement beyond the credit interest, including all fees and charges, and the conditions of the alteration thereof.

(7) The creditor or credit intermediary may only supply information on data items additional to those defined in this Section separately from the form attached hereto as Annex 1.

7. § (1) Simultaneously with the provision of the information under Sections 5 and 6 as well as in all information documents, the credit intermediary shall state whether it proceeds in the consumer's interest or on behalf of one or multiple creditors.

(2) The credit intermediary shall inform the consumer of all fees, charges and other payment liabilities payable by the consumer to it prior to the conclusion of the credit agreement, and shall commit the agreement thereon to paper or any other durable media.

(3) If there is any fee, charge or other payment obligation lying with the consumer towards the credit intermediary that proceeds on behalf of the creditor, the credit intermediary shall inform the creditor of the rate of such payment obligation in the interest of the calculation of the annual percentage rate.

8. § (1) The consumer shall verify receipt of the form containing the required pre-contractual information and that he/she has received the information regulated in Sections 5-7 by signing a duplicate copy thereof.

(2) If the parties conclude the credit agreement via an identified electronic channel or in the form of an electronic deed, there is no need for signing under subsection (1) as a means of verification. In this case,

a) information on the modification of charges and fees may also be provided electronically,

b) the information on interest changes shall be provided on paper or any other durable media.

9. § If the creditor intends to enter into an agreement with the consumer as set forth in the form containing the pre-contractual information, at the consumer's request, the draft credit agreement shall be made available to the consumer free of any fees, charges or other payment obligations.

10. § If, based on the consumer's request, the credit agreement is concluded by way of a telecommunications medium under Act XXV of 2005 on service agreements concluded in the financial sector within the framework of distance sale (hereinafter referred to as the „Distance Sale Act") which does not permit the provision of the pre-contractual information under Sections 6 and 7, in particular, if it is concluded by telephone under Section 4(3) of the Distance Sale Act, the creditor or the credit intermediary shall, forthwith after the conclusion of the credit agreement, meet its obligation of providing pre-contractual information for the consumer under Sections 6 and 7 on paper or any other durable media.

11. § If, based on the consumer's request, the credit agreement is concluded by way of a telecommunications medium under the Distance Sale Act which does not permit the provision of the pre-contractual information under Sections 6 and 7, in particular, if it is concluded by telephone under Section 4(4) of the Distance Sale Act, the creditor or the credit intermediary shall, forthwith after the conclusion of the credit agreement, meet its obligation of providing pre-contractual information for the consumer under Sections 6 and 7 on paper or any other durable media.

12. § (1) If a mortgage loan is requested, the creditor or, as the case may be, the credit intermediary shall provide the following information for the consumer, based on the information supplied by the consumer, on paper or any other durable media in good time, before any credit agreement or offer becomes binding on the consumer:

a) general information on the mortgage loan product offered by the creditor with the content defined in Section I of Annex 3,

b) personalised information through the completion of the form referred to in Section II of Annex 3.

(2) The information referred to in subsection (1)b) shall be delivered prior to the credit assessment, in line with the credit purpose identified by the consumer (with respect to the specific credit amount and term).

(3) A consumer requesting a mortgage loan shall be informed of the competent organisation on issues related to the information defined in subsection (1) by stating a name and a telephone number.

13. § (1) Section 8(1) and Section 9 shall apply to requests for mortgage loans and financial leasing relating to real estate, with the proviso that the draft agreement shall be placed at the consumer's disposal minimum seven days prior to the conclusion of the agreement even without the consumer's request.

(2) The agreements under subsection (1) may not be concluded electronically; this, however, does not prevent the parties from resorting to electronic means as defined in Section 8(2) in respect of the fulfilment of the obligation to provide pre-contractual information and the verification thereof as well as in respect of the provision of the draft agreement if the relevant conditions exist.

Assessment of Borrowing Capacity (Creditworthiness)

14. § (1) The creditor shall evaluate the consumer's borrowing capacity on the basis of the available information. The detailed rules of the assessment of borrowing capacity are defined by law.

(2) Unless a legal rule issued on the basis of the authorisation hereof provides otherwise, the information may be based on the information supplied by the consumer and the consultation of credit reference services.

(3) If the parties agree on increasing the total credit amount after the conclusion of the credit agreement, the creditor shall repeatedly evaluate the consumer's borrowing capacity free of any fees, charges and other payment liabilities before the amendment of the credit agreement.

(4) If, based on the consultation of credit reference services, the creditor does not wish to enter into an agreement with the consumer, the creditor shall forthwith and free of charge notify the consumer of the outcome of the data disclosure made as part of the credit reference service and of the features of the credit reference service unless the fulfilment of the obligation of notification is precluded by law or a directly applicable legal act of the European Union with general force.

Formal and Content Requirements Applicable to Credit Agreements

15. § One copy of the credit agreement shall be handed over to the consumer.

16. § (1) Except as set forth in subsection (4), the credit agreement shall contain the following clearly and concisely:

1. type of credit,

2. names (company names) and mail addresses (head offices) of contracting parties,

3. name (company name) and mail address (head office) of credit intermediary,

4. term of credit,

5. total credit amount and drawdown conditions,

6. in the case of credit provided in the form of deferred payment in conjunction with the sale of a product or the provision of a service, description and cash price of the given product or service,

7. the credit interest and credit interest conditions, the relevant reference interest rate if any, and the frequency, conditions and procedural rules of the modification of the credit interest,

8. the annual percentage rate as at the date of the conclusion of the credit agreement, and all relevant conditions taken into account upon the calculation thereof,

9. the full amount payable by the consumer,

10. the amounts of the amortisation instalments payable by the consumer, number of amortisation instalments and frequency of amortisation, and order of accounting for amortisation instalments towards different credit interest debts,

11. in the case of principal amortisation for a fixed term, the consumer's right to receive a statement of the debt in the form of an amortisation table during the term of the credit agreement free of any fee, charge or other payment liabilities,

12. if the consumer is obliged to pay the credit interest and all other considerations over and above the credit interest, including any fees, charges and commissions, separately from the amortisation of the principal, the frequency, conditions and amounts thereof,

13. all commissions, fees, charges or other payment liabilities related to payment accounts or cash substitute payment instruments, unless the maintenance of the payment account or cash substitute payment instrument is not mandatory,

14. all further considerations beyond the credit interest, including all fees, commissions and charges, and the conditions of their modification,

15. the default interest or any other payment liability which may arise from the non-fulfilment of the obligation undertaken in the agreement,

16. consequences of non-payment,

17. where applicable, the obligation to pay the relevant notarial fees,

18. where applicable, identification of collateral and insurance,

19. the right of withdrawal (termination) or the lack thereof, the period during which the right of withdrawal exists, and the conditions, method and legal consequences of the exercise of the right of withdrawal (termination), including Section 21(4) and (5),

20. the existence of the right under Section 22 and the conditions of the exercise thereof,

21. the right of early repayment, the method of the exercise thereof, the costs of early repayment if any, and the method of the calculation thereof,

22. the right of termination with respect to the credit agreement and the consequences thereof,

23. whether there is any mechanism for the consumer for the out-of-court settlement of legal disputes arising from the agreement, to the jurisdiction of which the creditor subjects itself, and

24. name and head office of regulatory authority.

(2) If the conditions of the application of the various credit interest rates under subsection (1)7 are different, information shall be supplied with respect to the frequency, conditions and procedural rules of the modification of the credit interest in the case of every credit interest rate.

(3) If the instalments paid by the consumer do not forthwith result in the amortisation of the credit amount but are used to constitute capital during the periods and under the conditions defined in the credit agreement or an agreement attached thereto, the creditor shall lay down in the credit agreement clearly and concisely that payment of the instalments does not automatically result in the repayment of the full credit amount, unless the parties expressly so agree.

(4) A credit facility agreement attached to a payment account shall contain the following clearly and concisely:

a) the information referred to in subsection (1), paragraphs 1-5, 7 and 8,

b) the total credit charge as at the date of the conclusion of the credit agreement,

c) in the case of a credit facility attached to a payment account, on the basis of which the loan provided must be repaid at the creditor's notice, the creditor's right to demand the repayment of the total credit amount at any time,

d) conditions, method and legal consequences of the exercise of the right of withdrawal, and

e) all other considerations over and above the credit interest that may emerge following the conclusion of the credit agreement, including all fees, commissions and charges, and the conditions of the modification thereof.

(5) If the lack of any content item under this Section does not affect the coming into being of the agreement, the creditor shall compensate the consumer for any loss that may arise from the content deficiency of the agreement under the rules of liability for losses caused through a breach.

17. § (1) At the consumer's request, the creditor shall place at the consumer's disposal a statement of the consumer's debts in the form of an amortisation table during the term of the credit agreement free of any fees, charges or other payment liabilities.

(2) In the case of mortgage loans, the creditor shall provide information on the debt for the consumer once annually and/or on the effective day of the interest period in the form of an amortisation table free of any fees, charges or other payment liabilities.

(3) The amortisation table shall contain the amounts of the amortisation instalments, the frequency and conditions of amortisation, and the principal and credit interest elements of each amortisation payment and the element of all other considerations over and above the credit interest, including all fees, commissions and charges, separately. If the rate of the credit interest is not fixed or all other considerations over and above the credit interest, including any fees, commissions and charges, may change as defined in the credit agreement, the amortisation table shall indicate clearly and concisely that the data made available is valid until the date of any change.

Terms and Conditions of Credit Agreements and the Alteration Thereof

17/A. § (1) Except as set forth in subsection (2), the creditor may not provide credit for a consumer, the annual percentage rate of which exceeds the central bank prime rate plus 24 percentage points.

(2) In the case of credit attached to credit card agreements or payment accounts or provided against pledged security, the annual percentage rate may not exceed the central bank prime rate plus 39 percentage points.

(3) In the case of credit provided for the purchase of every-day items and consumer goods (not including automobiles) and the use of services (hire purchase), if the credit is directly disbursed to the seller of the product or the provider of the service procured under hire purchase, the annual percentage rate may not exceed the central bank prime rate plus 39 percentage points.

(4) For the purposes of this Section, the central bank prime rate quoted on the first day of the month preceding the calendar biannual period concerned shall govern the entire term of the given calendar biannual period.

17/B. § (1) Only the credit interest, credit margin, charges and fees determined in the credit agreement may be unilaterally altered to the consumer's detriment, provided that it is permitted by this Act and it was expressly stipulated by the parties in the agreement. No other term or condition, including a stipulation relating to unilateral amendment, may be altered unilaterally to the consumer's detriment.

(2) The rate of interest or interest margin applicable during the new interest period shall be fixed with regard to the interest modification or interest margin modification indicator as on the 120th day before the end of the interest period.

(3) The creditor shall be entitled to exercise the right of unilateral amendment under subsection (1) under the terms and conditions laid down in the agreement, in accordance with the requirements defined in this Act. A contractual stipulation which does not conform to the requirements determined in this Act with respect to the unilateral amendment of the agreement is null and void.

(4) If the terms and conditions giving rise to the unilateral amendment of the credit agreement permit the reduction of the credit interest, the interest margin, the charges or fees, the creditor shall enforce such reduction to the consumer's benefit as part of its contractual obligations.

(5) Unless this Act provides otherwise, the consumer shall be informed of the unilateral amendment of the agreement under subsection (1) minimum 60 days prior to its entry into force in the manner determined in Section 18(5).

(6) In the case of the unilateral amendment of the terms and conditions of a credit agreement attached to a credit card or payment account, the consumer may terminate the agreement at 30 days' notice free of any charge or fee even if the agreement was concluded for a fixed term. The termination of the agreement is valid if the consumer repays the credit amount drawn and the credit interest under the agreement that may be charged up to the date of repayment by the end of the notice period.

17/C. § (1) Credit with a maximum term of 3 years may be provided

a) against a fixed rate of interest determined in the credit agreement, or

b) against a variable rate of interest tied to a reference interest rate published on the website of the National Bank of Hungary and a fixed interest margin,

and the interest conditions of such loans may not be unilaterally altered to the consumer's detriment.

(2) Credit with a term of more than 3 years may be provided

a) against a variable rate of interest tied to a reference interest rate published on the website of the National Bank of Hungary and a fixed interest margin for the entire term thereof or fixed for minimum interest periods of 3 years,

b) against fixed credit interest for minimum interest periods of 3 years, or

c) against fixed interest.

(3) The term of the last interest period of the credit under subsection (2) may also be shorter than 3 years.

17/D. § (1) In the case of a credit agreement with interest tied to a reference interest rate, the reference interest rate shall be adjusted to the reference interest rate quoted 2 days before the last business day of the month preceding the effective day at intervals corresponding to the term of the reference interest determined in the credit agreement.

(2) The creditor may change

a) the credit interest maximum in line with the interest modification indicator defined in the agreement and published on the website of the National Bank of Hungary,

b) the interest margin maximum in line with the interest margin modification indicator defined in the agreement and published on the website of the National Bank of Hungary

maximum five times during the term of the credit facility, after the end of the given interest periods.

(3) If, as part of the interest modification under subsection (2), the creditor applied a more favourable credit interest rate or interest margin than that permitted by the interest modification or interest margin modification indicator, the creditor may, in subsequent interest periods, offset the discount granted in respect of the rate of the interest or interest margin against the rate of interest or interest margin to be reduced up to the extent thereof.

(4) If, as part of the modification of the interest or interest margin, the creditor wishes to use an interest modification or interest margin modification indicator or a reference interest rate not published by the National Bank of Hungary, the creditor shall previously file a report thereon to the National Bank of Hungary with an introduction thereof as set forth in subsection (5). If the interest modification indicator, interest margin modification indicator or reference interest rate so reported conforms to the requirements set forth in this Act, the National Bank of Hungary shall publish such indicator or rate on its website within 30 days of reporting; in a case to the contrary, the National Bank of Hungary shall refuse the publication thereof by proceeding within its regulatory powers.

(5) The interest modification and interest margin modification indicators or the reference interest rate as well as the conditions of the application thereof shall be submitted in a report

furnished with an easy-to-understand explanation, and the creditor shall provide for the publication thereof in the same manner.

(6) The interest modification or interest margin modification indicator or the reference interest rate intended to be applied shall be determined in the credit agreement and may not be unilaterally altered even after the end of the interest period, including any constituent thereof. If, however, the interest modification or interest margin modification indicator or the reference interest rate becomes unsuitable for the performance of its function due to a material change in the circumstances that determine the development thereof, the National Bank of Hungary shall delete it from its website and shall simultaneously designate the interest modification or interest margin modification indicator or reference interest rate to replace the same.

17/E. § (1) The creditor may only establish or alter – in proportion to the increase thereof – charges, over and above the interest, to the consumer's detriment which it identified in the agreement on an itemised basis and which emerged directly during the course of the conclusion or amendment of the agreement and communication with the consumer in the consumer's interest in connection with the services of a third party in a way that permits the shifting thereof onto the consumer.

(2) The creditor may stipulate any fees other than interest, not including the fees that may be charged under this Act against costs directly related to the disbursement of the credit, the placement of the credit facility at the consumer's disposal and early consumer repayments, in connection with its costs related to the conclusion, amendment and termination of the agreement and its administrative costs by laying them down in the credit agreement on an itemised basis, and may raise these fees maximum by the rate of the previous year's annual consumer price index published by the Central Statistical Office.

(3) The creditor may alter its charges as and when they arise, while its fees once annually, effective as of 1 April.

(4) The fees determined in the agreement as a percentage rate may be determined in the currency of the credit, while the fees and charges fixed on an itemised basis may only be determined in HUF.

17/F. § In the event of belated payment on the consumer's part, the creditor may charge the consumer default interest for the term of the delay maximum at a rate which does not exceed one and a half times the transaction interest stipulated in the credit agreement plus maximum 3 percentage points and may not be higher than the maximum rate of the annual percentage rate as defined in Section 17/A in respect of credit agreements.

Obligation of Providing Information on Changes in the Credit Charges

18. § (1) Except as set forth in subsections (3) and (4), in the event of any changes in the interest conditions of the credit, the creditor shall inform the consumer minimum 90 days prior to the end of the interest period of

a) the rate of the interest or interest margin applicable during the new interest period,

b) the expected amounts of the amortisation instalments payable after the change, and if the number of amortisation instalments or the frequency of amortisation changes in consequence, of the fact thereof.

(2) Except as set forth in subsections (3) and (4), in the event of changes in the fees or charges other than interest, the consumer shall be informed of the fact of the change and the new rate of the fee or charge and shall be given the information under subsection (1) b) minimum 30 days prior to the entry into force of the change.

(3) In the case of credit provided with state interest subsidies, any changes concerning the credit interest, fees or charges shall be disclosed to the public in an announcement minimum 15 days prior to the entry into force of the change.

(4) In the case of credit interest tied to a reference interest rate, in departure from subsection (1), the parties may agree in the credit agreement that the creditor shall regularly inform the consumer of any changes in the reference interest rate on its website and in announcements posted on its premises open to customers.

(5) If the credit agreement is concluded in the form of an electronic deed,

a) the information on changes in the charges and fees may also be provided electronically,

b) any information on changes in the interest rate may be provided on paper or any other durable media, with the proviso that non-observance or belated observance of the communication time limits shall result in the forfeiture of rights in the case of a change that is detrimental to the consumer.

(6) In the case of the provision of an electronic commerce service, any information on changes and alterations shall also be made available to consumers electronically on an ongoing basis and by easily accessible means.

Obligation of Providing Information on Credit Attached to Payment Accounts

19. § (1) In the case of a credit facility attached to a payment account, the creditor shall regularly furnish the consumer with the information defined in subsection (3) on paper or any other durable media.

(2) The information under subsection (1) shall be provided as subsequent information as defined in Section 24(2) of Act LXXXV of 2009 on the provision of money transaction services, with the frequency agreed upon by the parties in the credit facility agreement attached to the payment account.

(3) The creditor shall provide the following information for the consumer:

a) the period to which the information relates,

b) amount of drawdown and date of drawdown,

c) date of the previous last information and the balance of credit attached to the payment account that existed at that date,

d) the balance of credit attached to the payment account outstanding at the time of the communication of the latest information,

e) amount repaid and date of repayment, *f*) credit interest,

g) all other considerations due beyond the credit interest, including all fees, commissions and charges, and

h) minimum amount of repayment if there is such a stipulation.

(4) In the event of any change in the credit interest and all other considerations beyond the credit interest, including all fees, commissions and charges, to the consumer's detriment, the creditor shall inform the consumer, prior to the entry into force of the amendment, of the fact of the change, the new rate of the payment liability, the amounts of the amortisation instalments payable after the change and, if the number of amortisation instalments or the frequency of amortisation changes, the fact thereof, on paper or any other durable media.

(5) In the case of credit interest tied to a reference interest rate, in departure from subsection (1), the parties may agree in the credit agreement that the creditor shall regularly inform the consumer of any changes in the reference interest rate on its website and in announcements posted on its premises open to customers.

Credit Agreements Entered into for an Indefinite Term

20. § (1) The consumer may at any time terminate a credit agreement entered into for an indefinite term at the notice period stipulated in the agreement. Unless a rule of law provides otherwise, the stipulation of a notice period that is longer than one month is null and void.

(2) If a credit agreement entered into for an indefinite term grants the creditor the right of serving ordinary notice, the creditor may terminate the credit agreement entered into for an indefinite term by serving ordinary notice on paper or any other durable media at minimum two months' notice.

(3) The parties may agree in a credit agreement entered into for an indefinite term that the creditor is entitled to cancel the consumer's drawdown entitlement for reasons beyond the creditor's control identified in the agreement.

(4) In the case of cancellation under subsection (3), the creditor shall forthwith notify the consumer of the fact of cancellation and its reasons before the act of cancellation but after the act of cancellation, at the latest, on paper or any other durable media.

(5) The obligation of notification under subsection (4) shall not lie with the creditor if the fulfilment of the obligation of notification is precluded by a legal rule or a directly applicable legal act of the European Union with general force.

Other Provisions Relating to the Termination of Credit Agreements

20/A. § (1) If the rate of the interest or interest margin changes in the new interest period after the end of the interest period determined in the credit agreement to the consumer's detriment, the consumer shall be entitled to terminate the credit agreement free of any charge or fee.

(2) The consumer shall serve his/her termination notice under subsection (1) upon the creditor 60 days prior to the end of the interest period, and its validity shall be subject to the repayment of the consumer's outstanding debt towards the creditor on the last day of the interest period, at the latest.

20/B. § (1) Prior to the termination of the credit agreement, the creditor shall draw the attention of the consumer, the surety and the lien obligor not qualifying as a personal debtor, in a written notice sent to the consumer, the surety and the lien obligor, to the amount of the total outstanding and overdue debt, the rate of the interest and default interest payable, any further interest liabilities payable in the event of non-payment, and the expected legal consequences that may set in in the event of the non-payment of the debt.

(2) The creditor shall send its termination notice to the consumer, the surety and the lien obligor not qualifying as a personal debtor, the verification of which shall lie with the creditor.

(3) Prior to the termination of a mortgage agreement, simultaneously with the written payment notice and information referred to in subsection (1), the creditor shall present a statement of the development of the amortisation instalments paid by the consumer as of the conclusion of the agreement – aggregated for each year but, at the consumer's request, also in a monthly breakdown –, the amount of the repaid principal, the interest, default interest and other charges accounted for, any capitalised interest, and the outstanding debt.

20/C. § (1) In the case of housing credit agreements, after the expiry of a period of ninety days following the termination of the agreement, the financial institution may not charge default interest, charges and fees in excess of the transaction interest, charges and fees valid on the day before the day of termination due to non-performance on the consumer's part.

(2) If the agreements under subsection (1) are foreign currency-based and the agreement stipulates the determination of the amount of the outstanding debt in HUF for the event of the termination thereof, subsection (1) shall apply subject to the difference that, after the expiry of a period of ninety days following the termination of the agreement, the creditor may not charge default interest, charges and fees in excess of the transaction interest and handling charges valid on the day of termination due to non-performance on the consumer's part.

Right of Withdrawal

21. § (1) The consumer may withdraw from the credit agreement within fourteen days of the day of the conclusion of the agreement without stating his/her reasons if no credit has been disbursed yet. The consumer may terminate the credit agreement free of charge within fourteen days of the day of the conclusion of the agreement if the credit has already been disbursed.

(2) If the consumer receives the information under Sections 6 and 7 after the conclusion of the agreement on the basis of Section 8, in departure from the provisions set forth in subsection (1), he/she may exercise his/her right of withdrawal (termination) for a period of fourteen days reckoned from the receipt of such information.

(3) The right of withdrawal (termination) shall be regarded as duly exercised in a timely fashion if the consumer posts or sends in any other verifiable manner his/her declaration thereon to the creditor by the end of the time limits determined in subsections (1)-(2), in accordance with Section 16(1), paragraph 19.

(4) The consumer shall repay the creditor the credit amount drawn and the contractual credit interest that may be charged as of the date of the drawdown until the date of repayment forthwith after the sending of his/her declaration of withdrawal (termination) but within thirty days, at the latest.

(5) In the event of withdrawal by the consumer, other than the amount referred to in subsection (4), the creditor shall only be entitled to the amount that it paid the State or a local government in connection with the credit, provided that there is no scope for the refunding thereof.

(6) The exercise of the consumer's right of withdrawal shall also dissolve any agreement relating to ancillary services attached to the credit which may relate to services provided by the creditor or, based on the prior agreement of a third party and the creditor, by such third party.

Provisions Relating to Foreign Currency-Based Credit

21/A. § (1) If the creditor wishes to enter into a credit agreement with the consumer that is recorded in a foreign currency or is provided in a foreign currency but is repayable in HUF (hereinafter referred to as „foreign currency-based"), as part of its obligation of providing information under this Act, the creditor shall disclose to the consumer the risks that lie with the consumer in connection with the contractual transaction and shall verify the acknowledgement thereof with a statement signed by the customer.

(2) The risk disclosure statement shall contain a detailed description of the exchange rate risk that arises from foreign currency-based credit agreements and the effect thereof on the amortisation instalments.

21/B. § (1) In the case of foreign currency-based consumer credit agreements, upon the disbursement of the loan, the amount of the loan and the amount of the amortisation instalment denominated in HUF that will fall due monthly shall be calculated, except as set forth in subsection (2), at the official foreign exchange rate quoted and published by the National Bank of Hungary in the capacity of central bank.

(2) If the creditor quotes its own average foreign exchange rate, the amounts expressed in HUF under subsection (1) shall be calculated, at the creditor's discretion,

a) at its own average foreign exchange rate quoted and published by the creditor, or

b) at the official foreign exchange rate quoted and published by the National Bank of Hungary.

(3) The creditor may not charge a separate fee or charge in connection with the conversion and calculation performed in accordance with subsection (1).

(4) The provisions of subsections (1)–(3) shall also apply if the amortisation instalments are not paid with monthly regularity and if the consumer repays a part or the full amount of his/her outstanding debt early.

(5) The provisions of this Section need not apply if the amortisation instalments are paid in a foreign currency.

Linked Credit Agreements

22. § (1) The exercise of the consumer's right of withdrawal based on statutory provisions passed with a view to the transposition of the relevant mandatory legal act of the European Union in respect of an agreement for the sale of a product or the provision of a service shall also dissolve the linked credit agreement.

(2) In the case of a linked credit agreement under Section 3, sub-paragraph 15 b), if

a) the seller or the provider of the service falls into arrears with the performance of the agreement entered into with the consumer or the defective performance of the agreement frustrates the use of the product or service according to its designated purpose, and

b) the seller or the provider of the service failed to satisfy the consumer's claims arising from such delay or defective performance by the relevant deadline,

the consumer may retain the amortisation payment falling due on the basis of the credit agreement until the satisfaction of his/her claim.

(3) No credit interest or any other consideration beyond the credit interest, including any fees, commissions and charges, may be charged for the term of retention referred to in subsection (2).

(4) The consumer shall notify the creditor of the circumstances giving rise to the exercise of the right of retention on paper or any other durable media. The consumer may exercise his/her right of retention after such notification.

(5) In the case of a linked credit agreement under Section 3, sub-paragraph 15 b), the creditor and the seller or the provider of the service shall previously agree on notification of consumer claims arising from delays and/or defective performance which are not settled in a timely fashion as well as on the compensation for the creditor's interest revenue lost on account of the retention of the amortisation payment.

Early repayment

23. § (1) The consumer may in every instance avail himself/herself of the partial or full early repayment of the credit.

(2) In the event of early repayment, the creditor shall reduce the total credit charge in respect of the tranche repaid early by the credit interest and all other considerations over and above the credit interest which relate to the remaining term of the credit agreement based on its original maturity.

24. § (1) The creditor shall be entitled to compensation for its fair and objectively justified costs directly related to the early repayment, if any, if the early repayment falls on a period when the credit interest is fixed.

(2) The rate of the costs referred to in subsection (1) may not exceed one per cent of the amount repaid early if the term between the date of the early repayment and the maturity of the credit under the credit agreement exceeds one year.

(3) The rate of the costs referred to in subsection (1) may not exceed half a per cent of the amount repaid early if the term between the date of the early repayment and the maturity of the credit under the credit agreement does not exceed one year.

(4) The rate of the costs referred to in subsection (1) may not exceed the amount of the credit interest payable for the term between the date of the early repayment and the maturity of the credit under the credit agreement with regard to the terms and conditions in force at the time of the early repayment.

(5) The creditor shall not be entitled to the compensation under subsection (1) in the case of credit facility agreements attached to payment accounts.

(6) The creditor shall not be entitled to the compensation under subsection (1) if the early repayment was made on the basis of an insurance agreement concluded as repayment collateral.

(7) The creditor shall not be entitled to the compensation under subsection (1) if the amount of the early repayment made by the consumer once during a period of twelve months does not exceed two hundred thousand forints.

25. § (1) In the event of the early repayment of a mortgage loan, the creditor shall be entitled to compensation for its costs emerging due to the early repayment. The rate of the costs enforced may not exceed 2 per cent of the amount repaid early, except as set forth in subsection (2).

(2) In the case of loan agreements financed with mortgage deeds, including loan agreements refinanced by a mortgage credit institution, the creditor shall also be entitled to enforce its costs related to the early repayment in excess of the rate determined in subsection (1) if the early repayment falls on a period when the interest of the mortgage loan is fixed or if the mortgage loan bears variable interest and the early repayment takes place during the interest period. In this case, the rate of the costs so enforced may not exceed 2.5 per cent of the amount repaid early.

(3) The creditor may not prescribe any further payment liability during the course of the early repayment over and above the costs referred to in subsection (1) or (2).

(4)[8] In the case of housing mortgage loans, the rate of the enforced costs may not exceed 1% of the amount repaid early in the case described in subsection (1) and 1.5% of the amount repaid early in the case described in subsection (2), unless the partial or full early repayment is made, whether partially or fully, from a loan disbursed by another financial institution.

[8] Established by Section 7(1) of Act XCVI of 2010. In force as of 27 November 2010.

(5)[9] The creditor shall not be entitled to the compensation under subsection (1) or (2) if the early repayment was made on the basis of an insurance agreement concluded as repayment collateral.

(6)[10] The creditor shall not be entitled to the compensation under subsection (1) or (2) in the event of the consumer's partial or full early repayment (final amortisation) if the consumer's outstanding debt does not exceed one million forints and made no early repayment during the preceding twelve months.

(7)[11] In the case of housing mortgage loans, the creditor shall not be entitled to the compensation under subsection (1) or (2) on the occasion of the first partial or full early repayment (final amortisation) made after a period of twenty-four months reckoned from the entry into force of the agreement, unless the partial or full early repayment (final amortisation) is made, whether partially or fully, from a loan disbursed by another financial institution or the amount repaid early exceeds one half of the loan amount determined in the loan agreement.

Overrunning

26. § (1) During the course of the conclusion of the framework agreement relating to the opening of a payment account under Act LXXXV of 2009 on the provision of money transaction services, the parties may agree that the consumer is entitled to overrun his/her credit limit.

(2) In the event of an agreement under subsection (1), the creditor shall regularly furnish the consumer with the information referred to in Section 6(3), paragraph 7 on paper or any other durable media.

(3) If the term of overrunning exceeds one month, the creditor shall forthwith inform the consumer of the data set forth in subsection (4) on paper or any other durable media.

(4) The creditor shall inform the consumer of the following data:

a) the fact of overrunning,

b) the amount of overrunning,

c) the credit interest, and

d) the default interest or any other payment liability which may arise from overrunning for a period of more than one month.

Procedure for the Event of the Violation of the Provisions Relating to Credit Provided for Consumers

27. § (1)[12] Compliance with the provisions of this Act and the legal rules issued for the implementation hereof shall be monitored by the National Bank of Hungary which shall proceed in the event of the violation of these provisions, not including the establishment of the coming

[9] Established by Section 7(1) of Act XCVI of 2010. In force as of 27 November 2010.

[10] Promulgated by Section 7(2) of Act XCVI of 2010. In force as of 27 November 2010.

[11] Promulgated by Section 7(2) of Act XCVI of 2010. In force as of 27 November 2010.

[12] Amended by Section 145 of Act CXLIII of 2013.

into being, validity, legal consequences and termination of agreements and the establishment of breaches and their legal consequences, and except as set forth in subsection (2).

(2) In the event of the violation of the provisions of this Act and the legal rules issued for the implementation hereof regarding commercial practices vis-à-vis consumers, in particular, the provision of information for consumers, the authority identified in the law on the prohibition of unfair commercial practices vis-à-vis consumers shall proceed in accordance with the rules set forth therein.

Other Provisions

28. § (1) If the creditor assigns its claim against the consumer to a third party, the consumer shall be entitled to submit a statement of claim against such third party in respect of his/her claim against the original creditor.

(2) If the creditor assigns its claim against the consumer to a third party, the creditor has no obligation to inform the consumer thereof if, based on the agreement entered into with such third party, it continues to proceed as creditor vis-à-vis the consumer also after the assignment of the claim.

(3)[13] In the case of mortgage loans, the creditor shall not be entitled to charge any fee, commission or charge determined at its discretion for the extension of the term if the term was not extended within a period of five years.

(4)[14] In the case of mortgage loans, if the consumer is in arrears by minimum ninety days with the fulfilment of his/her obligation existing on the basis of his/her agreement, the consumer may initiate the extension of the term by maximum five years, in writing, on a single occasion during the term. The creditor may not refuse such a request without good reason. In this case, the provisions set forth in subsection (3) shall apply to the fees, charges and commissions.

(5) The creditor shall be entitled to compensation as a disbursement fee for its costs directly related to the disbursement of the credit and determined in the agreement; however, the rate thereof may not be higher than 1% of the amount disbursed and may not exceed HUF 200,000.

(6) The creditor shall be entitled to charge a commitment fee in relation to the amount of the credit facility for keeping the credit facility available; however, the rate thereof may not be higher than 50% of the transaction interest expressed in percentage.

29. § (1) The consumer may not validly waive his/her rights defined in this Act.

(2) If the credit agreement is closely related to a Member State of the European Economic Area, the selection by the parties of the law of a third country as the governing law of the agreement is invalid inasmuch as the law of such third country is contrary to the provisions –permitting no departure – of the legal rule of the said Member State transposing Directive

13 Promulgated by Section 8 of Act XCVI of 2010. Amended by Section 130b) of Act CCXXXVI of 2013.

14 Promulgated by Section 8 of Act XCVI of 2010. Amended by Section 130b) of Act CCXXXVI of 2013.

2008/48/EC of the European Parliament and of the Council. In any such issue, the law of the said Member State shall govern instead of the law of the parties' choice.

29/A. § (1) The organisations of financial institutions established for the representation of their interests as legal entities may, with the approval of the National Bank of Hungary, publish general terms of agreement serving as samples for the activities of financial institutions coming under the effect of this Act and sample rules incorporating such general terms of agreement.

(2) The use or application of the sample rules under subsection (1) approved by the National Bank of Hungary shall not qualify as a market practice prohibited by Act LVII of 1996 on the prohibition of unfair market practices and of the restriction of competition.

Closing Provisions

30. § The Government is hereby authorised to establish the following in a decree:

a) the detailed rules relating to the definition, calculation and publication of the annual percentage rate;[15]

b)[16] the detailed rules of the assessment of borrowing capacity (creditworthiness), not including the income-proportionate amortisation instalment, and the rules relating to the maximum debt coverage ratio of real estate and automobile credit and financial leasing transactions.[17]

30/A. § The minister responsible for the regulation of the money, capital and insurance markets is hereby authorised to establish the following in a decree:

a) in the case of consumer suretyship agreements and consumer lien agreements attached to credit agreements, the detailed rules of the obligation of providing information for the surety and the lien obligor not qualifying as a personal debtor,

b) the detailed rules of the method and content of the provision of the information regulated in Section 5.

31. § (1) Except as set forth in subsections (2)-(3), this Act shall enter into force on the 15th day following its promulgation.

(2) Sections 1-3, 20-25 and 35 of this Act shall enter into force on 1 March 2010.

(3) Sections 4-19, 26-30, 34 and 36-38 of this Act shall enter into force on 11 June 2010.

(4)-(5)[18]

(6)[19]

32. § (1)[20] Except as set forth in subsections (2)-(7), the provisions of this Act shall solely apply to agreements concluded after 11 June 2010.

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15 See Government Decree No. 83/2010. (III. 25.).

16 Established by Section 144 of Act CXLIII of 2013. In force as of 1 October 2013.

17 See Government Decree No. 361/2009. (XII. 30.) and Government Decree No. 256/2011. (XII. 6.).

18 Repealed by Section 31(6) of the same Act. No longer in force as of 31 December 2010.

19 Repealed by the same subsection. No longer in force as of 1 January 2011.

20 Established by Section 9(1) of Act XCVI of 2010. In force as of 27 November 2010.

(2) The provisions of Section 20(3)-(5), Sections 21-25 and Section 35 of this Act shall solely apply to agreements concluded after 1 March 2010.

(3) In the case of credit agreements already concluded on 11 June 2010 for an indefinite term, the creditor shall meet the obligations of providing information laid down in Section 18, Section 19 and Section 26(2)-(4).

(4) The provisions set forth in Section 20(1) and (2) shall apply to credit agreements already concluded on 1 March 2010 for an indefinite term.

(5) Section 33 of this Act may be applied in execution proceedings instituted on the basis of execution requests filed after the entry into force hereof.

(6)[21] The provisions of Section 25(4)-(7) established by Section 7(1) and (2) of Act XCVI of 2010 on the amendment of certain laws covering financial subject-matters in the interest of helping consumers taking out loans for housing purposes who have found themselves in a difficult position (hereinafter referred to as the „Legislative Amendment") shall also apply to early repayments made after the fifteenth day reckoned from the entry into force of the Legislative Amendment in the case of agreements concluded prior to the entry into force of the Legislative Amendment.

(7)[22] The provisions of Section 28(3) established by Section 8 of the Legislative Amendment shall apply to term extensions initiated after the fifteenth day reckoned from the entry into force of the Legislative Amendment in the case of agreements concluded prior to the entry into force of the Legislative Amendment.

(8)[23] The provisions of Section 28(4) established by Section 8 of the Legislative Amendment shall apply to term extensions initiated after the thirty-fifth day reckoned from the entry into force of the Legislative Amendment in the case of agreements concluded prior to the entry into force of the Legislative Amendment.

(9)[24] The provisions of Section 28(3) and (4) established by Section 93b) of Act CCXXXVI of 2013 on the amendment of certain laws covering financial subject-matters (hereinafter referred to as „Legislative Amendment 2") shall apply to term extensions initiated after 1 February 2014 in the case of agreements concluded prior to the entry into force of Legislative Amendment 2.

33. § (1) The creditor shall amend its General Terms of Agreement and its business rules containing the same in accordance with the provisions of Act … of 2014 on the amendment of Act CLXII of 2009 on credit provided for consumers and certain related laws (hereinafter referred to as the „Amendment") effective as of 1 February 2015.

(2) The amendment of the General Terms of Agreement under subsection (1) shall form part of the agreements existing at the time of the entry into force of the Amendment without any further legal act on the part of the parties thereto. Consumers shall be informed individually of the contents of the agreements so amended.

21 Promulgated by Section 9(2) of Act XCVI of 2010. In force as of 27 November 2010.

22 Promulgated by Section 9(2) of Act XCVI of 2010. In force as of 27 November 2010.

23 Promulgated by Section 13 of Act CLXXIX of 2010. In force as of 31 December 2010.

24 Promulgated by Section 129 of Act CCXXXVI of 2013. In force as of 1 January 2014.

(3) As part of the amendment under subsection (2), the method for fixing the interest on credit either bearing fixed interest or tied to a reference interest rate with the addition of an interest margin and the terms and conditions of the interest so fixed may not change.

(4) If the remaining term of the credit exceeds 3 years, the creditor may alter the contractual terms and conditions by an interest modification or interest margin modification indicator published on the website of the National Bank of Hungary and through the determination of interest periods.

(5) The creditor may not determine further charges or fees in addition to the charges and fees determined on an itemised basis which came to form part of the credit agreement. Any charges and fees which were established in consumer agreements before the entry into force of the Amendment shall remain part of the agreements; however, the unilateral alteration thereof shall be governed by the provisions of the Amendment. The creditor may render provisions conforming to the provisions of Section 17/E(1)–(3) part of the agreement in respect of charges and fees determined on an itemised basis, subject to the notification referred to in subsection (2).

(6) In the case of consumer credit agreements not affected by settlement on the basis of Act XL of 2014 on the rules of settlement laid down in Act XXXVIII of 2014 on the settlement of certain issues related to the Curia's legal unity decision concerning the consumer loan agreements of financial institutions, and certain other provisions (hereinafter referred to as „Act XL of 2014), the creditor shall meet its obligation under subsection (2) by 31 December 2015, at the latest. If the creditor meets this obligation prior to this deadline, the prohibition of the unilateral raising of interest rates, charges and fees defined in Section 45(1) of Act XL of 2014 shall be lifted, and in this context the creditor shall have the option to make changes in accordance with the agreements amended in harmony with the provisions of the Amendment.

(7) The creditor may report the interest modification and interest margin modification indicators and the reference interest rate intended to be applied by it as of the day of the entry into force of this provision on the basis of Section 17/D(4) and (5) established by Section 6 of the Amendment, and the National Bank of Hungary may examine and publish the same, or may decide to refuse the publication thereof.

(8) If a consumer loan agreement is affected by the settlement under Act XL of 2014, the provisions of a separate law shall govern instead of the provisions set forth in subsections (4) and (5).

34. § The provisions of Sections 17/A–17/F, 18, 20/A–20/C, 21/A, 21/B, 28(5), 29/A and 33 of this Act established by the Amendment shall apply to unterminated consumer agreements concluded after 1 May 2004.

33-37. §[25]

38. § This Act serves compliance with the following legal acts of the European Union:

[25] Repealed by Section 31(6) of the same Act. No longer in force as of 31 December 2010.

a) Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC [Sections 1, 2.(1)-(2), 3-11, 14-16, 17(1) and (3), 18-24, 26-32, 34 and 36-38 and Annexes 1 and 2],

b) Commission Recommendation 2001/193/EC (1 March 2001) on pre-contractual information to be provided to consumers by lenders offering home loans (Section 12 and Annex 3).

Annex 1 to Act CLXII of 2009

General Pre-Contractual Information Prior to Conclusion of Credit Agreement

1. Details of creditor/credit intermediary	
creditor's name (company name)	... [name[
mail address	... [address to be used by consumer]
telephone number*	...
e-mail address*	...
fax number	...
internet website address*	...
where applicable, credit intermediary's name (company name)	... [name]
mail address	... [address to be used by consumer]
telephone number*	...
e-mail address*	...
fax number*	...
internet website address*	...
* completion of marked fields is not compulsory	
Whenever the term „where applicable" is used, the creditor is only required to complete the given field in respect of the given data item if it is applicable to the credit; if not, the line must be deleted. The relevant data must be entered in place of the text in [...].	
2. Description of material characteristics of credit	
type of credit	...
total credit amount amount of credit stated in credit agreement or upper limit of amount available for drawdown	...
conditions of drawdown of credit method and date of placement of credit	...
term of credit	...

amortisation instalments and method of settlement	You are required to make the following payments: ... *[amounts of amortisation instalments, number of amortisation instalments, frequency of amortisation]* Method of payment of credit interest and all other considerations, including fees, commissions and charges: ...
total amount payable principal and credit interest and all other considerations, including fees, commissions and charges	... *[total credit amount and total credit charge]*
where applicable, in the case of credit provided in the form of deferred payment in connection with the sale of products or the provision of services, description and cash price of product or service	...
where applicable, the required collateral	
characteristics of collateral required for credit agreement	... *[type of required collateral]*
where applicable payment of amortisation instalments does not forthwith result in amortisation of credit amount	...
3. Consideration related to credit	
credit interest rate or rates	...% ... *[fixed or variable credit interest; in case of latter, initial reference interest rate; term of each credit interest rate]*
annual percentage rate (APR)	...%
ratio of total credit charge to total credit amount expressed in percentage per annum; the APR helps to compare different offers	... *[all terms and conditions of representative example]*
required for conclusion of credit agreement: - insurance or - existence of any other ancillary service agreement; if the creditor is not aware of the consideration payable for these services, they are not included in the APR	yes/no [if yes, type] ... yes/no [if yes, type] ...
all considerations over and above credit interest, including fees, commissions and charges	...
where applicable, one or multiple payment accounts required for conclusion of credit agreement	...
where applicable, all commissions, fees, charges or other payment liabilities related to cash substitute payment instrument	...

where applicable, all other considerations over and above credit interest, including fees, charges and commissions	...
where applicable, conditions of alteration of all considerations over and above credit interest, including fees, commissions and charges	...
where applicable, notarial fee	...
default interest or any other payment liability arising from non-fulfilment of obligations undertaken in the agreement; defaulting on your payments may have serious consequences for you (e.g. execution of pledged property) and may render access to credit more difficult	You will incur the following payment liabilities if you default on your amortisation instalments: ... *[applicable credit interest and default interest]*
4. Other legal information	
existence of right of withdrawal you have the right to withdraw from the credit agreement within 14 days	yes/no
early repayment you are entitled to repay your credit early partially or fully	...
where applicable, costs of early repayment if any in case of early repayment, the creditor is entitled to compensation for the following costs	... *[compensation for costs related to early repayment to be defined as per provisions of Section 24]*
information under Section 14(4) the creditor is required to notify you forthwith and free of charge of the outcome of any data disclosure made upon the consultation of any credit reference services if the creditor does not wish to enter into an agreement with you on the basis of the outcome of such credit reference services. This obligation does not lie with the creditor if the fulfilment of the obligation of notification is precluded by a rule of law or a directly applicable legal act of the European Union with general force.	...
right to one copy of draft credit agreement you have the right to receive one copy of the draft credit agreement from the creditor free of any fee, charge or other payment liability this obligation does not lie with the creditor if the creditor does not wish to enter into an agreement with you	...
where applicable, temporal restriction of validity of this information	This information is valid from … until …

5. Where applicable, supplementary information to be provided in the case of credit agreements concluded as part of distance sale	
name (company name) of representative of creditor in the Member State of the consumer's place of residence	... *[name]*
mail address	... *[address to be used by consumer]*
telephone number*	...
e-mail address*	...
fax number*	...
internet website address*	...
creditor's company register number or court registration number	... *[company register number or court registration number]*
regulatory authority licensing creditor's activities	...
exercise of right of withdrawal	... *[conditions, method and legal consequences of exercise of right of withdrawal (termination); further, address (e-mail address, fax number) to which the consumer is required to send his/her declaration of withdrawal (termination)]*
law applicable by creditor during period before conclusion of agreement	...
governing law, and stipulation of exclusive competence and jurisdiction	... *[reference to relevant contractual provision]*
language regime	... *[language of pre-contractual information, language of conclusion of agreement, and language of communication with consumer during term of agreement agreed upon with consumer]*
out-of-court settlement of legal disputes arising from agreement	
availability of any mechanism which the creditor subjects itself to	...

Annex 2 to Act CLXII of 2009

Information for Credit Facility Agreement Attached to Payment Account

1. Details of creditor/credit intermediary	
creditor's name (company name)	... *[name]*
mail address	... *[address to be used by consumer]*

telephone number*	...
e-mail address*	...
fax number	...
internet website address*	...
where applicable, credit intermediary's name (company name)	... *[name]*
mail address	... *[address to be used by consumer]*
telephone number*	...
e-mail address*	...
fax number*	...
internet website address*	...
* completion of marked fields is not compulsory	
Whenever the term „where applicable" is used, the creditor is only required to complete the given field in respect of the given data item if it is applicable to the credit; if not, the line must be deleted. The relevant data must be entered in place of the text in [...].	
2.[26] Description of material characteristics of credit	
type of credit	...
total credit amount amount of credit stated in credit agreement or upper limit of amount available for drawdown	...
term of credit	...
where applicable, the creditor may at any time call upon you to repay the full amount of your credit	...
3. Consideration related to credit	
credit interest rate or rates	...% ... *[fixed or variable credit interest; in case of latter, initial reference interest rate; term of each credit interest rate]*

[26] Established by Section 95 and Annex 3, Section 1 of Act XCVIII of 2013. In force as of 29 June 2013.

annual percentage rate (APR) ratio of total credit charge to total credit amount expressed in percentage per annum; the APR helps to compare different offers	*...%* *... [all conditions of representative example]*
where applicable, all other considerations over and above credit interest, including fees, commissions and charges, and conditions of the alteration thereof	*... [All other considerations over and above credit interest payable as of conclusion of agreement,]*
default interest or other payment liabilities arising from the non-fulfilment of obligations undertaken in the agreement	*You will incur the following payment liabilities if you default on your amortisation instalments: ... [applicable credit interest and default interest]*
4. Other legal information	
termination of credit agreement	*... [conditions and method of exercise of right of termination]*
information under Section 14(4) the creditor is required to notify you forthwith and free of charge of the outcome of any data disclosure made upon the consultation of any credit reference services if the creditor does not wish to enter into an agreement with you on the basis of the outcome of such credit reference services. This obligation does not lie with the creditor if the fulfilment of the obligation of notification is precluded by a rule of law or a directly applicable legal act of the European Union with general force.	...
where applicable, temporal restriction of validity of information	This information is valid from … until …
5.[27] Where applicable, supplementary information to be provided in the case of credit agreements concluded as part of distance sale	
name (company name) of representative of creditor in the Member State of the consumer's place of residence	*... [name]*
Address	*... [address to be used by consumer]*
telephone number*	...
e-mail address*	...
fax number*	...
internet website address*	...

[27] Established by Section 95 and Annex 3, Section 2 of Act XCVIII of 2013. In force as of 29 June 2013.

creditor's company register number or court registration number	... *[company register number or court registration number]*
regulatory authority licensing creditor's activities	...
exercise of right of withdrawal	
You have the right to withdraw from the credit agreement within 14 calendar days.	... *[conditions, method and legal consequences of exercise of right of withdrawal (termination); further, address (e-mail address, fax number) to which the consumer is required to send his/her declaration of withdrawal (termination)]*
law applicable by creditor during period before conclusion of agreement	...
governing law, stipulation of exclusive competence and jurisdiction	... *[reference to relevant contractual provision]*
language regime	... *[language of pre-contractual information, language of conclusion of agreement, and language of communication with consumer during term of agreement agreed upon with consumer]*
availability of any mechanism for the out-of-court settlement of legal disputes arising from agreement which the creditor subjects itself to	...

Annex 3 to Act CLXII of 2009

I. General Information on Mortgage Loans

1. Details related to creditor:

1.1. creditor's name (company name) and address (head office),

1.2. if any, credit intermediary's name (company name) and address (head office).

2. Details related to mortgage loan:

2.1. purposes for which credit may be used,

2.2. collateral securing mortgage loan,

2.3. types of mortgage loans offered by creditor, with brief description of differences between loans bearing fixed and variable interest, including impacts concerning consumer; where applicable, interest margin, interest modification or interest margin modification indicator,

2.4. types of interest: fixed, variable or a combination of these,

2.5. charges of a typical mortgage loan that lie with the consumer:

2.6. list of costs related to mortgage loans, e.g.: administrative, insurance, legal and intermediary charges,

2.7. amortisation options offered by creditor, including number and amounts of amortisation instalments, and frequency of amortisation,

2.8. possibility of early repayment and its conditions,

2.9. whether appraisal of property serving as security is required, if so, by whom,

2.10. general information on tax benefits and other state subsidies related to the amortisation of housing credit, and information on where further information is obtainable,

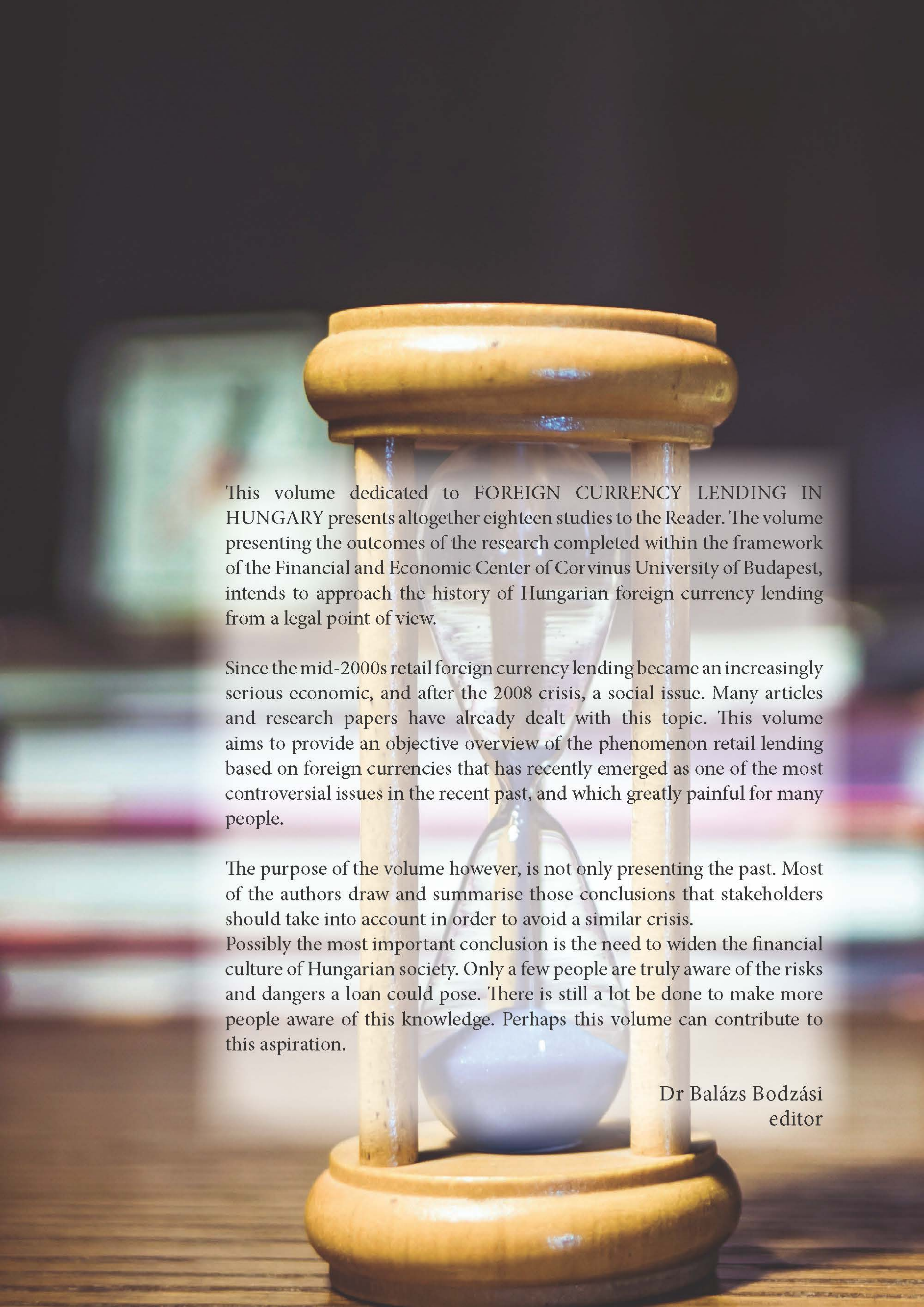
2.11. where applicable, term of credit assessment.

II. Personal Information on Mortgage Loans

Category of information	Description
Introductory text	„This information does not qualify as a legally binding offer. The creditor provides the data stated in this information in good faith and it reflects its offer that it would make on the basis of the available information under the present market conditions. The data featured herein may change in the event of changes in the market conditions. This information imposes no obligation on the creditor to approve the credit."
1. Creditor	
2. Description of product	Brief, easy-to-understand introduction of product It must be made clear whether it relates to mortgage established on real estate or any other generally applicable collateral. It must be made clear whether, in the case of the product offered, payment of the principal debt is due in one sum at the end of the term or whether the consumer amortises both interest and principal during the term of the credit. It must be made clear whether the terms and conditions of the credit depend on the size of the consumer's own resources (e.g. expressed in percentage of value of home). It must be made clear whether the terms and conditions of the credit depend on suretyship undertaken by a third party.
3. Interest (stating type of interest and term of fixed interest period)	In case of variable interest, introduction of scenarios in which it may change. Whether there is a preferential interest period and what conditions and penalties are attached thereto in case of early repayment. Whether there is an upper or lower cap on the interest rate. In case of variable interest rate, whether it is an indexed interest rate, and if so, details of indexing.

4. Annual percentage rate	
5. Amount and currency of credit	
6. Term	
7. Number and frequency of amortisations	
8. In case of permanent (annuity) amortisation, amount of each amortisation instalment	
9. Only in case of interest amortisation credit products combined with investment	To be stated if grace period is granted: a) amount and frequency of each interest payment (see item 7), b) amounts and frequency of payments into investments used for principal amortisation (see item 7). The consumer's attention must be drawn to the fact that there may be scenarios when the amount paid into the investment does not cover the amount of the loan. It must be stated clearly whether the offer depends on whether the consumer accepts the given form of investment.
10. Other one-time charges	List of one-time charges which the consumer is required to pay to take out the mortgage loan. If such one-time charges fall within the creditor's direct or indirect control, it is necessary to state their estimated amount. It is necessary to state whether payment of the charge depends on the outcome of the credit assessment. One-time charges, e.g. administrative charges, legal fees, notarial fees, appraisal fee. It is necessary to state if the offer depends on whether the consumer uses the services linked to the credit via the creditor.
11. Other regular costs (not listed under item 8)	These costs e.g., - premium of credit collateral insurance, - premium of fire insurance, - premium of insurance of immovable and movable property. It is necessary to state if the offer depends on whether the consumer uses the services linked to the credit via the creditor.
12. Early repayment	The creditor is required to state the following: - possibility and conditions of early repayment, - fees related to early repayment. If the relevant fees cannot be determined at this stage, it is necessary to state that the consumer is required to pay the creditor's costs arising from repayment prior to maturity.

13. Internal complaint handling	Contact person's name, address and telephone number
14. Amortisation table	The creditor is required to provide a summary amortisation table for demonstration purposes which must contain minimum the following: - monthly or quarterly amortisation instalments (where applicable) for the first year, - annual amortisations during the entire term of the loan. The following data must be stated in the table: - amount of repaid principal, - amount of interest, - amount of outstanding principal, - amount of each amortisation instalment, - amount of principal and interest. It must be stated clearly that the table serves demonstration purposes, and further the consumer must be alerted if the interest on the offered credit is variable.
15. Payment account	It must be stated clearly whether it is compulsory for the consumer to keep an account with the creditor and/or to have his/her income transferred to an account kept with the creditor.



This volume dedicated to FOREIGN CURRENCY LENDING IN HUNGARY presents altogether eighteen studies to the Reader. The volume presenting the outcomes of the research completed within the framework of the Financial and Economic Center of Corvinus University of Budapest, intends to approach the history of Hungarian foreign currency lending from a legal point of view.

Since the mid-2000s retail foreign currency lending became an increasingly serious economic, and after the 2008 crisis, a social issue. Many articles and research papers have already dealt with this topic. This volume aims to provide an objective overview of the phenomenon retail lending based on foreign currencies that has recently emerged as one of the most controversial issues in the recent past, and which greatly painful for many people.

The purpose of the volume however, is not only presenting the past. Most of the authors draw and summarise those conclusions that stakeholders should take into account in order to avoid a similar crisis.
Possibly the most important conclusion is the need to widen the financial culture of Hungarian society. Only a few people are truly aware of the risks and dangers a loan could pose. There is still a lot be done to make more people aware of this knowledge. Perhaps this volume can contribute to this aspiration.

Dr Balázs Bodzási
editor